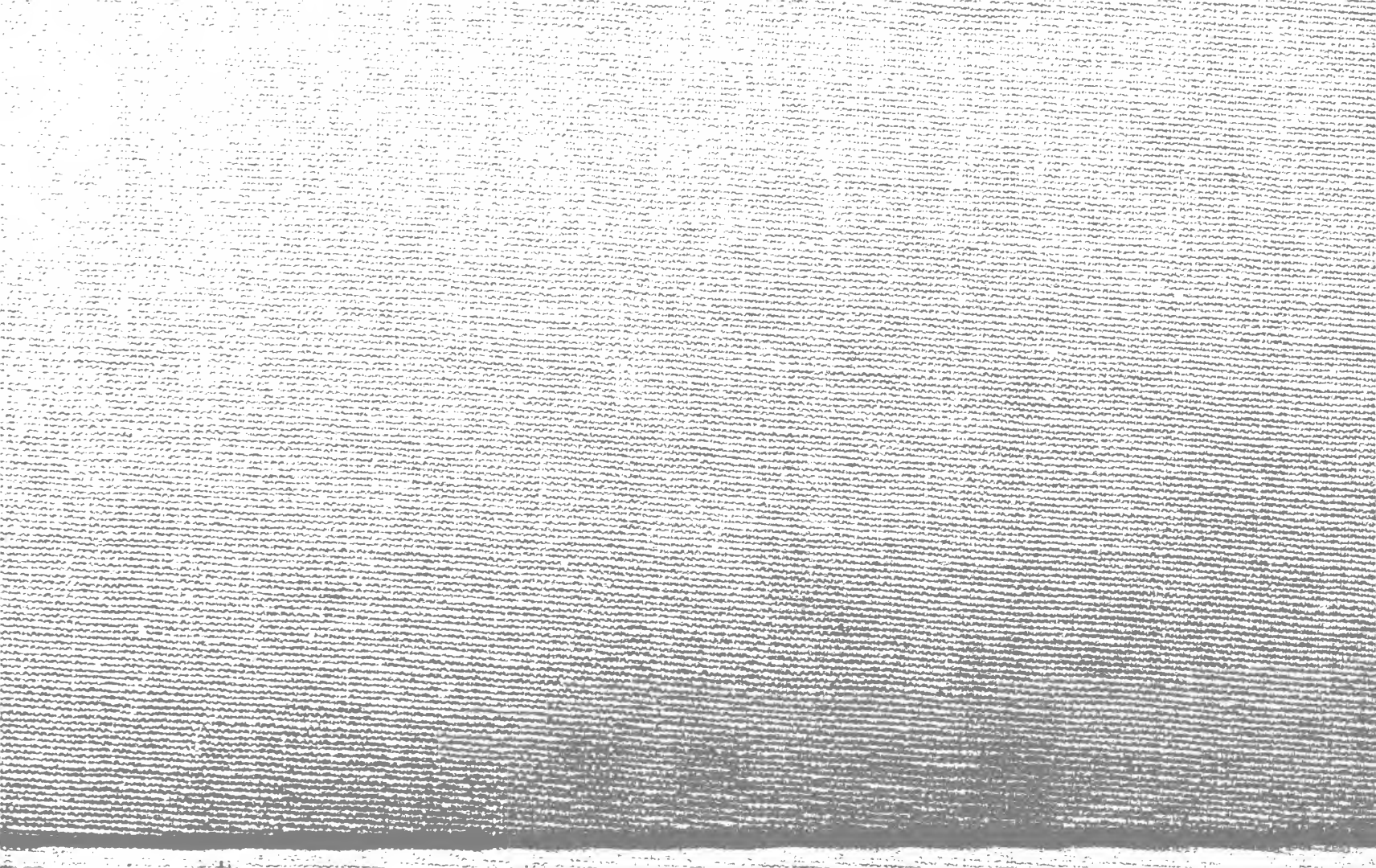

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VOL 3246

No. 16815

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CATHERINE C. STARK,

Appellant,

VS.

ARTHUR S. FLEMMING, SECRETARY OF THE DEPARTMENT OF HEALTH, EDUCATION AND WELFARE OF THE UNITED STATES,

Respondent.

APPELLANT'S BRIEF

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No. 16815

IN THE

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CATHERINE C. STARK,

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Respondent.

APPELLANT'S BRIEF

I. STATEMENT OF JURISDICTION

The jurisdiction of the District Court rests upon a statutory review of a final decision of the Secretary of the Department of Health, Education and Welfare of the United States which denied appellant's claim for old-age insurance benefits. Appellant invoked this jurisdiction by filing her complaint for review of this decision within the time allowed by law.

> (Tr. 1) Sec. 205(g) of the Act of Congress of August 14, 1953 as amended, 49 Stat. 624, 42 U.S.C.A. Sec. 405(g).

Summary judgment was entered against the appellant in the United States District Court for the Northern District of California, Southern Division, in proceeding No. Civil 38250 on December 8, 1959. The jurisdiction of this Court is conferred by a statutory provision that the courts of appeal shall have jurisdiction of appeals from all final decisions of the District Courts of the United States.

> (Tr. 17) Sec. 12(e) of the Act of Congress of July 7, 1958, as amended, Public Law 8-508, 72 Stat. 348, 28 U.S.C.A. Sec. 1291.

II. STATEMENT OF THE CASE

Appellant instituted this action in the District Court for a statutory review of a final decision of the Secretary of the Department of Health, Education and Welfare denying her claim for old-age benefits. The Secretary's denial was based on the ground that appellant had received no wages within the meaning of the Social Security Act, because the corporation by which she was employed was a sham whose entity should be disregarded and that therefore the compensation she received was rental income which did not constitute wages under the Act. The District Court concluded that the findings of the Secretary were supported by substantial evidence. Appellant asserts that there is no direct evidence to support the findings that the corporate entity should be disregarded and none from which such an inference can be drawn and, furthermore, that in any event, she rendered services which would be covered by the Act.

III. SPECIFICATION OF ERRORS

The appellant specifies the following errors as having been committed by the District Court:

A. The Court erred by concluding that the findings of the Secretary were supported by substantial evidence.

B. The Court erred by concluding that said findings were supported by inference that could properly be drawn from the evidence.

C. The Court erred by concluding that appellant's services were minimal in extent.

D. The Court erred by concluding that appellant's salary was disproportionate to the services she rendered.

E. The Court erred by concluding that no plausible reason existed for the incorporation.

F. The Court erred by concluding that the Secretary could disregard the corporate entity.

G. The Court erred by concluding that appellant was not entitled to benefits under the Social Security Act.

H. The Court erred by entering summary judgment for the defendant.

IV. THERE IS NO SUBSTANTIAL EVIDENCE TO SUPPORT THE SECRETARY'S DECISION THAT THE CORPORATE ENTITY SHOULD BE DISREGARDED.

A. Summary of Argument.

This case involves a decision of the District Court granting appellee's motion for summary judgment and denying appellant's motion for summary judgment based on the pleadings and the Referee's Transcript. The District Court proceeding was an appeal from the Referee's decision which had been adopted as the final decision of the Secretary of the Department of Health, Education and Welfare. The entire Transcript is before this Court. The evidence contains nothing which will support the finding that the subject corporation was a sham and that its entity may be disregarded. Any inference drawn from the evidence to that effect is without substantial basis and is therefore unwarranted and unreasonable.

B. Summary of the Facts.

Prior to her husband's death appellant and her husband had owned a farm in North Dakota for many years. (Tr. 37.) In addition, appellant had assets of her own consisting of a duplex in Oakland, California, and a certain amount of cash. (Tr. 82, 83, 100.) The appellant and her husband had the custom of spending their summers in North Dakota and their winters in California. On January 27, 1956, the husband died in Oakland, California. (Tr. 36.) Shortly after her husband's death appellant discussed with her son, Frank-

lin C. Stark, the desirability of having him assist her in policy-making decisions in connection with the farm and city properties. He agreed to do so if a corporation were formed to give them limited liability. It is to be noted that both of them had assets other than what was put into the corporation. (Tr. 40-41, 83.) After the corporation was formed the appellant transferred to it all of the assets of her husband's estate and in addition, the duplex which she owned in Oakland. These assets exceeded in value the sum of $36,000. (Original File v. 2, p. 117.) She was appointed general manager at a salary of $400.00 per month. (Tr. 43, 66.) She performed numerous duties for the corporation and was the only person during the period of time involved in active management. The services Mrs. Stark rendered were extensive. The record indicates that her duties as president and general manager called for a full time job and that she averaged in excess of 40 hours per week. (Original File v. 2, 103.) The various transcript references to Mrs. Stark's duties are referred to in Appendix "A" and will not be repeated here. However, because of the importance of the question, the type of duties she discharged will be reviewed. She received and disbursed all funds of the corporation, maintained the corporate records and prepared the payroll tax returns. In connection with the farm she obtained storage facilities for the crops, arranged for repairs and maintenance, negotiated a crop-lease, discussed with the tenant and other people the type of crops to be planted under the crop-lease, made attempts to sell the farm so that the money could

be invested in more productive property, sold personal property on the farm, reviewed various data on soil conservation and determined the correct crops to be planted, supervised lessee in carrying out the crop-lease, paid the taxes and insurance and arranged for the disposition of her share under the crop-lease. In connection with the duplex she not only collected the rent and made necessary payments on the loan, but arranged for repairs which were required and obtained a new tenant when a vacancy occurred.

The extent of her services can best be obtained by reading the excerpts from the minutes of the meetings of the Board of Directors which appear on pages 120 through 124 of Volume 2 of the Original File. The various services reported show that they were extensive and completely in keeping with the intent of Congress under the Social Security Act.

Appellant continued in active management until she became ill and was forced to retire on her doctor's orders. (Tr. 59, 100-101, 103, 104.) (Original File V. 2, p. 110, 111, 114, 115.)

C. There Is No Evidence to Permit Disregard of the Corporate Entity.

The District Court found that the inference drawn by the Secretary that the corporate entity should be disregarded was supported by the evidence. (Tr. 11-16.) The Secretary's decision is, of course, based on the Referee's decision contained in the Transcript at

pages 22 through 32. Merely putting a label on a set of circumstances does not solve the problem, and in this case calling the corporation a sham cannot eliminate a careful review of the evidence. Such a review shows that there is no evidence whatsoever which can support a finding that the subject corporation was a sham. The most that can be said for the Referee's decision (and this was the position taken by the District Court) is that an inference to that effect can be drawn from the evidence. However, such an inference can only be drawn if supported by all the evidence and it is improper to choose a few unfavorable points and disregard the favorable ones.

In *Goldman* v. *Folsom* (C.A. 3rd, 1957), 246 F. (2d) 776, the court held that the decision by the Referee subsequently adopted by the Secretary was not supported by substantial evidence. A Referee cannot pick out some evidence and ignore other evidence but must consider the case as a whole. Thus the Court stated at page 779 as follows:

> "The referee while noting the testimony and affidavits of the claimant's five fellow-employees as to her employment chose to ignore them as part of the evidential scene despite their disinterested character.
>
> "He ignored too, the testimony of the claimant's physician that she was mentally incompetent at the time she gave Brobyn the June 25, 1954 statement and chose instead to accept the

'opinion' of mental competency of a layman, Brobyn, who had spent only 45 minutes with the claimant on that date and who had only observed her for an hour or so four months earlier.

"The referee also chose to accept the hearsay testimony of Brobyn that Florence Polk who had witnessed the June 25th statement had stated at the time that she 'knew' the contents of the statement to be true despite the fact that Mrs. Polk testified that she was not present at the time the statement was given, that she was not aware of its contents and most significantly that she had not been employed by the claimant and did not know her during the 1951-53 claimant-employment period. Moreover, the referee on the score of mental competency, failed to note Mrs. Polk's testimony that the claimant didn't seem to know what she was doing at times in June, 1954 and 'she didn't know too much about her affairs'; 'her memory was very well' and 'her condition gradually got worse.' "

Where a Referee expressed an opinion on the physical condition of a claimant the Court in *Jacobson* v. *Folsom* (S.D. N.Y. 1957), 158 F. Supp. 281, stated at page 285:

"Such a lay observation as was made by the Referee can only have been based on surmise and speculation and is certainly of insufficient probative value to derogate from plaintiff's testimony supported by medical records."

Thus we can see, as these authorities indicate, that the entire record should be reviewed by the Court and if the Secretary has drawn inferences which are unwarranted and unreasonable when related to the entire record, then his decision must be reversed. See also *MacPherson* v. *Ewing* (N.D. Cal. S.D., 1952), 107 F. Supp. 666, *Fuller* v. *Folsom* (W.D. Ark. 1957), 155 F. Supp. 348, and *Miller* v. *Burger* (C.A. 9th, 1947), 161 F. (2d) 992.

The term "wages" is defined in Section 209 of the Social Security Act (42 U.S.C.A. 409), in terms of remuneration paid for "employment." Section 210(a) of the Act (42 U.S.C.A. 410[a]), defines the term "employment," so far as pertinent here, as "any service, of whatever nature, performed after 1950 . . . by an employee for the person employing him . . ." The term "employee" is defined in Section 210(k) of the Act (42 U.S.C.A. 410[k]), as meaning:

> "(1) any officer of a corporation; or
>
> "(2) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee; . . ."

The Referee's attempt to justify his disregard of the corporate entity is based on the four following assertions:

1. That the services were worth little or nothing. (Tr. 29.)

2. Rental income was incorporated, thus, turning non-social security income into social security income. (Tr. 30.)

3. The corporation lost money. (Tr. 30.)

4. The corporation was formed to take advantage of the Social Security Act. (Tr. 29-30.)

Of course, it has been established that no one of these factors, taken by itself, could permit a disregard of the corporate entity except possibly the first one. Thus, it has been clearly established that any person has a legal right to pursue his business in the corporate form, and there is nothing to prevent a corporation from engaging in a rental business if it so desires, nor is there anything wrong in a person setting up his business in such a way as to qualify for social security benefits.

In *Rafal* v. *Flemming* (E.D. Va., 1959), 171 F. Supp. 490, a father sold his business to his sons and the purchase price was to be paid in installments over a period of time. After the sale he discovered that he was not qualified for social security but that he could be qualified if he were to go into partnership with his sons. Accordingly, he re-entered the business which he had sold to his sons as a partner under an agreement by which the profits paid to him were credited to the purchase price. In determining that the plaintiff was entitled to social security benefits the court said at p. 492:

> "It is considered by all parties that there is nothing improper or questionable about a person entering bona fide employment for the express purpose of acquiring a wage record which will enable him to qualify for old-age insurance benefits, and that such action is clearly within the spirit, as well as the letter, of the law."

As noted above, the Referee refers to the motive of the plaintiff in incorporating. However, in addition to the *Rafal* case cited above, the court in *MacPherson* v. *Ewing*, *supra*, 107 F. Supp. 666, at p. 667, states as follows:

> "To permit the Administrator to rest decision upon the *motives* of the employer or upon the *effectiveness* or *adequacy* of the employee's services or labor, absent any element of fraud or deceit, would be to entrust to him a power far beyond that statutorily conferred upon him."

The Referee also stresses the fact that the corporation lost money but, again, this factor does not permit him to disregard the corporate entity.

This is clearly demonstrated by a recent decision of this Court in *Flemming* v. *Lindgren* decided January 20, 1960 and reported at 275 F. (2d) 596. In that case the claimant had attained the age of 65 and then filed an application for Social Security benefits. He was told that he could not receive such benefits because his employment had been agricultural, to wit, raising

fryers on a three acre tract on the edge of Portland. He consulted his attorneys about arrangements necessary to obtain social security coverage and as a result a corporation was organized for the primary purpose of obtaining social security coverage for him. Lindgren transferred to the corporation his chickens, some cattle and four incubators. The initial assets of the corporation amounted to $2,500.00. The claimant was made President of the corporation and his wife Secretary and Treasurer. Although she worked in the business she received no salary for her services. The salary of the claimant as President was set at $300.00 per month, this amount being at the time the exact maximum creditable for social security purposes. Later on his salary was reduced to $75.00 per month to permit him to draw social security benefits. Then when the amount permissible was increased by law his salary was raised to $100.00 per month to conform to the increase. The Referee stated that the evidence clearly demonstrated that the business of the corporation was conducted in the same manner after incorporation as the claimant had conducted it before. The corporation operated at a loss and in order to meet its obligations, including claimant's salary, it was necessary for it to borrow money. This money came from the claimant who was issued promissory notes therefor. The real property which was owned by Lindgren and on which the fryer business was conducted was not transferred to the corporation. Nevertheless, no rent was ever paid for use of this land although his attorney testified that $50.00 per month was a reasonable rental

therefor. The tax returns failed to take into account any expense for rent and did not reflect the promissory notes.

The Referee denied Lindgren benefits, and this decision was sustained by the Secretary. The District Court determined that the Secretary's decision was arbitrary and capricious and entered judgment for the claimant. This Court failed to agree with the position taken by either the District Court or the Secretary and directed the District Court to send the matter back to the Secretary for re-determination. It recognized, however, that the mere fact that the corporation was losing money was insufficient to refuse benefits to the claimant, stating at page 597:

> "We realize that in his recommendations to the secretary the examiner came up with a handy rule . . . limit the salary to the amount of the earnings of the company, such being the amount that the corporation with negligible capital could sensibly afford to pay. Unless the corporation is held a complete sham and is entirely vitiated, in which case Lindgren would be back in his agricultural self-employed category ineligible for the benefits, we think that the secretary should have taken into account some other factors . . . because the test is, What is 'wages' under the act? He should reconstruct a reasonable wage under all of the circumstances. These might include past history of the same little business, wages of a laborer doing the same type of work as Lindgren, and perhaps a number of other

factors will come to mind. Probably no one single factor should control.

"It does appear that perhaps in the two years involved, economics were against Lindgren more than usually. The corporation did have a few assets. In the long run a corporation's earning record limits the salaries it can pay, but some pay more than they can afford for a while and then go out of business, or often they survive to become profit-making organizations. And persons nonetheless have had help in getting social security — all as a by-product of the over-payment.

"We realize the scope of the review by the district court and by us is limited. But we do hold that an arbitrary standard was applied when no factor other than the exact actual earnings of the corporation was applied. Our decision still leaves the administrator of the act broad latitude for the exercise of his discretion."

In the *Lindgren* case the Secretary had relied on the case of *Gancher* v. *Hobby* (Conn., 1955) 145 F. Supp. 461.

The Government has relied on the *Gancher* case in denying the benefits in the present case. However, it should be observed that in the *Gancher* case no bona fide services were rendered to the corporation. There the claimant had transferred two vacant lots and a building in which his family resided and in which he had an office to qualify himself. There was only one

apartment occupied by an outsider. The Referee, in the *Gancher* case, stated that the picture of the claimant making rental payments to himself and then paying himself for services, approached the farcial. See the discussion of the *Gancher* case in *Rafal* v. *Flemming*, *supra*, 171 F. Supp. 490, at page 495. In our case the appellant did not occupy the real property which constituted the corporate assets. Both parcels were income producing property, one a farm, the other a duplex. Furthermore, the record will show that she did render substantial bona fide services.

Basically, the Referee just doesn't like the fact that it is possible to form a corporation and qualify. (Tr. 29-30.) However, the law permits this as the *Lindgren*, *Rafal* and *MacPherson* cases show and if there is to be any change in the law, it should come from Congress not from administrative interpretation.

There is no evidence whatsoever of fraud in this case. Nor is there any evidence that the corporation itself or the employment of appellant was a sham. The Referee states that the corporation had no bona file business purpose (Tr. 30) but he has no right to substitute his judgment for those of the parties involved. There are many factors besides qualifying for social security benefits that make a corporation desirable. As we have indicated earlier in this brief, the desire here was for limited liability. However, as we have stated, the motive was immaterial for it is perfectly proper to form a corporation to take advantage of social security benefits.

The Referee attempts to belittle the services of appellant. (Tr. 26-27.) He even goes so far as to state that they were not even worth $50.00 in any quarter. (Tr. 29.) The record is replete with evidence showing that the services of appellant were substantial. See transcript references in Appendix "A." They were reasonably worth $400.00 per month. In any event, they were certainly worth at least $50.00 per quarter. However, it is not for the Referee to define the exact value of these services so long as substantial services were rendered and this is clearly established by the record. The Referee also relied on the fact that the corporation lost money. Obviously, he would not disqualify all employees of businesses that are losing money. What he really objects to is the fact that he feels this corporation was set up to qualify the appellant. That this is permitted by law is clearly shown by the cases heretofore cited:

Flemming v. *Lindgren, supra*

Rafal v. *Flemming, supra*

MacPherson v. *Ewing, supra*

The Referee states that to uphold the corporate entity will permit an evasion of law. (Tr. 30.) He argues that rental income by itself does not qualify for social security and that one cannot evade this rule by incorporating rental income. (Tr. 31.) He overlooks the fact that extensive personal services were rendered as has been indicated several times. Refer-

ence to these services are contained in the Appendix. Furthermore, where services are rendered in connection with rental income, such income is included for social security purposes.

> *Thorbus* v. *Hobby* (S.D. Calif., 1954), 124 F. Supp. 868, affirmed in *Folsom* v. *Poteet* (C.A. 9th, 1956), 235 F. (2d) 937.

The applicable statutory provisions relating to rentals are as follows:

> "There shall be excluded rentals from real estate . . . (including such rentals paid in corp shares) . . . except that . . . this . . . shall not apply to any income derived by the owner . . . if (A) such income is derived under an arrangement, between the owner . . . and another individual, which provides that such other individual shall produce agricultural . . . commodities . . . on such land, and that there shall be material participation by the owner . . . in the production or the management of the production of such agricultural . . . commodities and (B) there is material participation by the owner . . . with respect to any such agricultural . . . commodity . . ." Act. of Congress of August 28, 1950, c. 809, Title I, Sec. 104(a), 64 Stat. 492 as amended, 42 U.S.C.A. 411(a) (1).

In 1956 Congress had before it proposed amendments to extend the coverage of the Social Security Act. The Senate Report which is No. 2133 reported in the U. S. Code Congressional & Administrative

News, Volume 3, 1956, commencing at page 3877, contains some excellent references to the intent of Congress in connection with this statute. Referring to the general purpose of the Act, the Senate Report at page 3877 states as follows:

> "The old-age and survivors insurance program is designed to provide partial protection against loss of earned income upon the retirement or death of the worker."

At this session the Senate had before it a proposed amendment to include as self-employment income receipts by an owner who had made a crop-lease and thereafter materially participated in its management. In considering this amendment and also that extending the coverage to other persons, including attorneys, the Report stated at page 3878 as follows:

> "Your committee has consistently held the view that the coverage of the program should be as nearly universal as is practicable."

And then at page 3930:

> "Your committee is of the opinion that in any case in which the owner or tenant establishes the fact that he periodically advises or consults with such other individual as to the production of the commodities and also establishes the fact that he periodically inspects the production activities on the land he will have presented strong evidence of the existence of the degree of participation contemplated by the amendment."

The record in our case clearly shows that Mrs. Stark periodically advised and consulted with Dexter Wobig who had a crop-lease for the farm which had been transferred to the corporation She had also periodically inspected the production activities on the land. It will be recalled that she made one trip in the summer of 1956 and was prevented from doing so in 1957 because of her disability. However, at all times she maintained periodical inspections through her relatives whom she contacted by correspondence. (Tr. 54, 56-57, 86, 90, 96, 97. Original File, V. 2, pp. 121, 120, 122, 112, 123 and 124.) It should also be noted in considering the Congressional intent the expressed desire that the program should be as nearly universal as practicable. The law itself specifically provides that an officer of a corporation is an employee. There are no exceptions in the Act such as those which the government attempts to read into this case. 42 U.S.C.A. 410(k) (1).

It is submitted that the recognition of the corporate entity in this case will actually carry out the intent of Congress. The only situation in which it should be disregarded is where some fraud has been practiced. There is no fraud or deceit in the present case. There is no sham. We are here concerned with a valid existing corporation which was set up at a logical time upon the death of claimant's husband and into which she transferred all of the assets of the estate, together with the income producing portion of her separate property. It was done at a time to permit the participation of her son without personal liability on his part.

Mrs. Stark testified that as far as she knew the corporation was not formed to take advantage of the Social Security Act. This may, of course, have been the intent of her son since it was only after discussing the entire matter with him that a corporation was decided upon. If it had not been for Mrs. Stark's illness she could have continued to operate the corporation and receive a salary which would have been considerably in excess of any social security benefits.

The existence of the separate corporate entity is extremely important in modern industry and business and its stability is essential for tax as well as other purposes. The courts have consistently recognized this principle. In *Skarda* v. *The Commissioner of Internal Revenue* (C.A. 10th, 1957), 250 F. (2d) 429, at page 434, the Court stated as follows:

> "Where the purpose for creating the corporation is to gain an advantage under the law of the state of incorporation, relieve the stockholders from personal liability for debts created by the corporation, or serve the creator's personal convenience, so long as that purpose is the equivalent of business activity, or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."

In another case involving 100% stock ownership by one individual the Court in *Gardner* v. *The Calvert* (C.A. 3rd 1958), 253 F. (2d) 395 cer. den. May 19, 1958, stated at p. 398 as follows:

> "It is a well settled rule that a corporation is for most purposes an entity distinct from its individual shareholders . . . and only in exceptional instances may the separate corporate identity be disregarded."

D. Conclusion.

It is respectfully submitted that there is not only no substantial evidence, but no evidence, and no evidence from which a reasonable inference can be drawn, to support the decision of the Secretary which adopts the decision of the Referee and that accordingly the motion for summary judgment by the Appellee should have been denied and the motion for summary judgment by the Appellant should have been granted, and that therefore this Court should make an order reversing the decision of the District Court and directing it to enter a summary judgment in favor of the Appellant.

Dated at Oakland, California, this 22nd day of June, 1960.

Respectfully submitted,

J. Warren Manuel,
Attorney for Appellant.

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APPENDIX A

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No. 16,815

IN THE

United States Court of Appeals

For the Ninth Circuit

CATHERINE C. STARK,
Appellant,

vs.

ARTHUR S. FLEMMING, SECRETARY OF THE DEPARTMENT OF HEALTH, EDUCATION AND WELFARE OF THE UNITED STATES,
Appellee.

BRIEF FOR APPELLEE.

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Appellee.

BRIEF FOR APPELLEE.

JURISDICTION.

Jurisdiction is founded under Title 28 United States Code, Section 1291.

PROCEEDINGS BELOW.

Catherine C. Stark, appellant herein, filed application for old-age and survivors insurance benefits with the Bureau of Old-Age and Survivors Insurance of the Social Security Administration on July 2, 1957, alleging employment by Stark Properties, Incorporated, from February 15, 1956, to June 30, 1957 (Exh. p. 92). After due investigation the Bureau determined

that remuneration received from Stark Properties, Incorporated, was not wages under the Social Security Act, and the appellant was so notified by letter on November 20, 1957 (Exh. p. 107). Dissatisfied with the determination, the appellant on May 8, 1958, requested a hearing before a referee of the Social Security Administration (Exh. p. 109). Such a hearing was held on October 28, 1958, with the appellant present and represented by counsel (Tr. 31 et seq.). On November 25, 1958, the referee rendered his decision denying the appellant's claim (Tr. 18-24).

On December 23, 1958, the appellant requested a review of the referee's decision (Tr. 16), which request was denied on April 3, 1959 (Tr. 15). Under the regulations of the Social Security Administration, when the Appeals Council denied said request for review, the referee's decision became a "final decision" of the Secretary of Health, Education and Welfare within the meaning of, and subject to judicial review pursuant to the provisions of Section 205(g) of the Act (42 U.S.C.A. 405(g)).

On May 18, 1959 appellant filed an action under Title 42, U.S.C., Section 405(g) for review of the decision of the Secretary of Health, Education and Welfare. The Government filed the transcript in the above matter with its answer and subsequently moved for Summary Judgment. In an opinion handed down on November 23, 1959 United States District Judge William T. Sweigert granted the Government's Motion for Summary Judgment. *Stark v. Flemming,* 181 F. Supp. 539.

STATEMENT OF THE FACTS.

The appellant was born on May 30, 1888, and became age 65 on May 29, 1953 (Exh. Tr. 94). She had lived for many years with her husband on a farm in South Dakota which he owned. The farm was operated pursuant to a partnership arrangement between the appellant's husband and one Dexter Wobig, although her husband retained the sole ownership of the farm (Tr. 37, 48, 80, 95 et seq.). The appellant and her husband had spent several winters in California. While in California, the appellant's husband died on January 27, 1956. Since her husband's death the appellant has lived in California (Tr. 36, 48, 83).

Shortly after her husband's death, the appellant in consultation with her son, Franklin Stark, who lived in California decided to form a corporation. This corporation, known as Stark Properties, Incorporated, was formed as a California corporation on February 9, 1956 (Tr. 39; Exh. p. 99). All the assets of the corporation were contributed by the appellant. These assets consisted of a 160 acre farm in South Dakota which was left to her by her husband, the equity in a duplex house in Oakland, California, which she had owned since 1951, and $4,199.10 in cash which was left by her husband (Tr. 46 et seq., 81-82, 92). On December 29, 1956, the appellant also contributed $1,560 to the corporation (Tr. 44-45, 64-65, 97).

In consideration of the transfer of the equity in the duplex property which was about $2,000 and the initial cash contribution of $4,199.10 the appellant was issued 65 shares of stock with a par value of $100 a

share (Exh. pp. 117, 118). No further stock was issued to any other person and no more stock was issued to the appellant upon her later contribution of $1,560 (Tr. 97). In addition to the stock, $20,000 worth of debenture bonds were issued to the appellant in return for her conveyance to the corporation of the farm in South Dakota which was estimated to be worth $20,000 and which was held free of any encumbrances (Exh. pp. 117, 118).

The Board of Directors was composed of the appellant, her son and the son's wife. The appellant was president and treasurer of the corporation and it was agreed that she would receive $400 a month as remuneration for her activities in connection with the corporation (Tr. 43). Her son was the secretary of the corporation and her daughter-in-law, Alice Stark, acted as vice-president (Tr. 66). Neither the son nor the daughter-in-law received any remuneration for their activities in connection with the corporation (Exh. p. 103). The corporation's place of business was listed as the hotel room where the appellant lived (Tr. 46).

The appellant, in a written statement in evidence, alleged that she performed extensive tasks in connection with her position as president of the corporation. The appellant declared that she entered into leases for the corporation of the farm, took care of taxes, insurance and repairs with regard to the farm and unsuccessfully tried to sell that property. She also maintained that she managed the duplex property in Oakland and stated that she handled all the general book-

keeping and fiscal matters of the corporation. She concluded her written description of her duties by saying that "My job was a full time job and I averaged in excess of 40 hours a week on it." (Exh. p. 103.)

At the hearing under the guidance of her attorney the appellant repeated her earlier assertions as to her duties (Tr. 53 et seq.). However, when questioned by the referee the appellant experienced great difficulty in explaining her tasks and why they took up so much of her time (Tr. 94). She testified that the lessee, Dexter Wobig, was honest and experienced and that she wrote about one letter a week to him or to her sister-in-law and brother-in-law who lived across the road from the South Dakota farm (Tr. 95). She also stated that her efforts to sell the farm were principally confined to Mr. Wobig (Tr. 91). With regard to the duplex, the appellant stated that her tenants were prompt in paying their rent and that they mailed their payments to her. She either mailed in the mortgage payments on the duplex or went to the bank herself (Tr. 91). Repairs for the duplex were handled by telephone calls and the appellant testified that she had employed a hired man who took care of these repairs. This man was not employed by her at the time of the hearing but he had been employed by her for several months after the corporation was formed (Tr. 93-94). Although the appellant had alleged she kept the corporation's books she admitted that the entries in the books were made by a public accountant (Tr. 46). When asked by the referee how these duties could have required over 40 hours a week, the appellant re-

plied that when she wasn't actually performing services, she was thinking about the job (Tr. 94).

The appellant returned to the farm in South Dakota for about 3 or 4 weeks in the summer of 1956 (Tr. 51). While there, she sold some tools and equipment for $258.90 (Tr. 56, 89).

The appellant's son handled the legal matters of the corporation and prepared the corporation's income tax return. He also prepared the corporation's Book of Minutes (Tr. 44). As previously noted, the appellant was to receive $400 a month. She made out the checks to herself and the son signed them (Tr. 44); $4,200 was reported for the appellant as wages for 1956 and $2,400 was reported for the first six months of 1957 (Exh. p. 96). The corporation's financial statements showed a net loss of $3,221.78 for 1956 and a net loss of $671.12 for 1957. The parties admitted that they were well able to estimate the income and expenses of the corporation from the operation of the properties and thus, could have foreseen the losses which the corporation sustained (Tr. 77).

The appellant retired on July 1, 1957, from her positions as president and treasurer because of alleged ill-health (Exh. p. 99). She introduced into evidence her physician's records showing office visits from February through April 1957, and the record of a week spent in a hospital from February 27, to March 7, 1957 (Exh. pp. 114-115). Since her retirement the son has acted as president and treasurer, but has received no compensation (Tr. 100).

After discussing the evidence substantially as above, the referee proceeded with his findings, reasonings and conclusions as follows (Tr. 23-24):

> "It is perfectly apparent, and the referee finds, that the real purpose of forming this corporation was to qualify claimant for Social Security coverage. The income that she would otherwise have received from these properties was rent income, and as such is specifically excluded from coverage under the Social Security Act, Section 211(a)(1). The corporation clearly had no bona fide business purpose. The operation of these properties could just as well and much more cheaply have been carried on without the interposition of a corporation. Claimant's purported salary was startlingly excessive in the terms of good business management. The corporation was not organized for profit, on the contrary, it was formed with the expectation of running at a loss.
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> * * * * * * *
>
> "The basic purpose of congress in enacting the Social Security Act was to provide for the replacement of earnings lost by virtue of retirement. Only those persons were intended to be benefited who, on the basis of earnings for services rendered, had contributed to the maintenance of the Social Security fund. Contributions are in the form of taxes paid by the individual and his employer measured by the amount paid for services, which, it was assumed would be the fair value of the services rendered. Benefits are computed in proportion to the taxes so paid. Income from capital invested, including rents from real property, are definitely excluded from coverage. Nor was it

ever intended that a person could, simply by paying taxes from his private funds, become entitled to Social Security benefits—earnings from services rendered being the basis of benefits.

"It is clear and the referee finds that this corporation was designated to defeat this congressional purpose by (1) converting into purported employment income, income from rents, that Congress intended should be excluded from coverage, and by (2) using claimant's own funds as purported employment income for the purpose of making Social Security returns. The corporate entity, therefore, is in this case disregarded by the referee and he finds that claimant in her purported capacity of president and treasurer of said corporation was acting solely for herself, and that the amounts paid on her account as Social Security taxes were actually paid by herself from her own funds without basis in services rendered by her in any capacity, and so cannot serve to qualify her for Social Security benefits.

"It follows from the foregoing findings, and the referee finds and concludes, that claimant does not have six or more quarters of coverage as required by the Social Security Act, and was therefore not fully insured. It is his decision that she is not entitled to Old-Age Insurance Benefits as applied for by her."

Even apart from the effect of the substantial evidence rule (discussed infra), we submit that the findings of the referee including the controlling findings that the appellant "does not have six or more quarters of coverage as required by the Social Security

Act and was therefore not fully insured," are plainly correct.

QUESTION PRESENTED.

Was the District Judge correct in granting Summary Judgment for the defendant-appellee?

ARGUMENT.

From the facts as found by the referee in accordance with the evidence, there would appear to be no basis for any conclusion other than the one he reached. The appellant was actively connected with Stark Properties, Incorporated, for just 18 months or 6 quarters, the *minimum* period necessary to obtain an insured status under the Act. Furthermore, she withdrew $4,200 as remuneration for the first year, which was the *maximum* amount creditable as wages under the Act. In addition to the coincidence of time and amount, the evidence plainly shows that the corporate structure had never been used by the appellant or her husband prior to the years in issue and no plausible reason was advanced as to why it had suddenly been utilized contrary to previous practice.

The appellant alleged that she gave up her position as president on July 1, 1957, because she became ill. This explanation appears questionable because the evidence shows that the appellant was under a doctor's care earlier in that year while she was still president. She had improved by the summer when she chose to

retire. Moreover, when the appellant retired in July 1957, purported wages had been reported for her for the minimum period required for coverage under the Act. The amount of remuneration which appellant received further illustrates the contrived nature of the instant situation. The appellant received $4,200 in 1956 and $2,400 for the first six months of 1957, which amounts would obtain for her the maximum benefits under the Act. The duties which she performed did not warrant such compensation.

Most important, however, the evidence reveals that the appellant's activities were minimal. She only made one business trip to the farm in South Dakota after her husband's death. The lessee of the farm was experienced and there was little the appellant had to do. The same was true of the duplex apartments. The appellant admitted that her tenants were good and that the few dealings she had to transact could mostly be taken care of by mail and telephone. In the light of these facts, the appellant's assertion that she spent *in excess of 40 hours a week* performing her tasks appears dubious (Exh. 5, Tr. 103). When asked by the referee at the hearing how her simple duties could have required so much time the appellant said "My mind was working when my hands were not working" (Tr. 81).

The illusory character of the compensation which the appellant received is further made manifest upon the realization that the corporation did not earn enough in either 1956 or 1957 to pay the appellant from current earnings. The appellant's remuneration

was paid from capital funds. In the light of the fact that the appellant herself contributed the capital of the corporation it becomes clear that she was merely contributing funds to the corporation with one hand and taking them out with the other in the attempt to establish an earnings record to entitle her to benefits under the program.

When the appellant retired, her son took her place as president and treasurer. He received no compensation for his activities in connection with the corporation nor has the corporation compensated anyone else since the appellant gave up her offices. No explanation was advanced why the appellant was paid maximum creditable amounts, whereas it has not been necessary to compensate anyone else for services performed for the corporation since her retirement.

A case which bears a close resemblance to the instant matter is *Gancher v. Hobby,* 145 F. Supp. 461 (U.S. D.C. D. Conn. 1955). In that case the claimant, a physician, organized a corporation together with his wife and daughter and conveyed to the corporation a building which had been paid for by the claimant and was held in his wife's name. The building was composed of three residential apartments, two of which were occupied by the claimant and members of his family, and the claimant's office. The claimant and members of his family purported to pay the corporation rent and, in turn, the claimant purported to draw wages from the corporation for alleged services rendered to the corporation. The referee in the *Gancher* case denied the appellant's claim for benefits and denounced

schemes that are contrived merely to gain social security benefits in the following manner:

> "* * * There is nothing improper or questionable about a person entering bona fide employment for the express purpose of acquiring a wage record which will enable him to qualify for an old-age insurance benefit. Such action is clearly within the spirit, as well as the letter, of the law. However, it is a far different thing to create a relationship and give to certain payments the color of 'wages' for the purpose of qualifying under a law such as the one here in question. That is neither within the letter nor the spirit of the law. *Even though the Fredja Corporation might have certain legal respectability as far as State law is concerned, its organization apparently for the sole purpose of having claimant as one of its officers, and presumably as an employee, so as to qualify for social security benefits appears to have been nothing but a sham.* * * *" (Emphasis supplied.)

The court in the *Gancher* case affirmed the referee's conclusions and issued a Memorandum Decision in which it set out the essential fact-finding portions of the referee's decision, including that portion which we have quoted above, and held as follows:

> "A study of the testimony shows that the Referee's conclusions which were adopted and became the basis for the Department's decision, were amply supported by substantial evidence. The foundation of the corporation, the 'employment' of the appellant and his application for social security benefits were all features of what was intended to have been a *slick scheme concocted in the mind of the appellant's son, Louis Gancher, and engi-*

neered by him improperly to acquire contributions for his father's support from the Social Security administration. * * *" (Emphasis supplied.)

It is significant that in the instant case, as in the *Gancher* case the attempt was made to qualify an individual needing only 6 "quarters of coverage" for benefits by means of purported payments of wages, through the device of a corporation. That the alleged "salary" was the amount needed to gain the maximum benefit, under the Act is very significant, as is the fact that the alleged salary was alleged to give plaintiff the exact minimum of 6 "quarters of coverage." To allow the interposition of a corporation, formed solely as a scheme to enable the plaintiff to obtain a lifetime annuity under the Social Security Act, as the present one obviously was, is to nullify the purpose for which the old-age and survivors benefit program was established.

The cases cited by the appellant to support its position serve only to reinforce that of the government.

As the majority opinion in *Flemming v. Lindgren,* 275 F.2d 596 (9th Cir., 1960), stated (at p. 597) "where . . . [claimant] was using this rather shallow corporate device, the government was entitled to take not one but several long looks at it." The majority also pointed out that many factors should be considered and that the "decision still leaves the administrator of the Act broad latitude for the exercise of his discretion."

The concurrence was even more specific. Judge Pope distinguished this very case on the ground that, "The finding was that there was 'not in fact a bona fide employment for salary or wages,' " (at 598 footnote one). Furthermore, Judge Pope stated, "If it were found that the size and character and potentialities of that business were such that [the claimant] must have known that the business could never pay a salary sufficient to qualify him and if in consequence it were found and concluded that the employment was only a simulated one then the situation would be otherwise." (p. 599.) It should be noted that this is exactly the situation we have here.

In *Rafal v. Flemming,* 171 F. Supp. 490 (E.D.Va., 1959), plaintiff sold his packing business to his two sons for a consideration of $17,000 evidenced by a promissory note and retired from business. Two years later Rafal entered into a partnership agreement with his sons, under which it was agreed that he would be entitled to the sum of $3,600.00 per year from the profits of said partnership, which sums would be credited against the payment of the aforesaid negotiable promissory note. It was further agreed that the three partners would (1) share equally in the losses and (2) give undivided time and their attention to the business. It was conceded that Rafal worked 48 hours per week during all of 1954 and 1955, the years in question. The referee found that these earnings did not constitute net earnings from self-employment and that therefore Rafal was without sufficient quarters of coverage to be considered a fully insured individual under the provisions of the Social Security Act.

In effect, the referee ruled that plaintiff had made a gift of his services during the two years in controversy. The court in reversing the referee ruled that rather than a gift of his services Rafal had made a gift to his sons of the financial remuneration received for such services. The court pointed out that if the partnership had been without profits in the years in question the plaintiff would not have been entitled to any money and the note would not have been credited with any payments. Indeed, in such a situation, the sons would have been obligated to pay Rafal the $50 per week specified by the promissory note. The court discussed the case of *Gancher v. Hobby,* 145 F. Supp. 461 and distinguished it from the *Rafal* case as being in sharp contrast. The court noted that there had been no "bona fide" services rendered to the corporation in the *Gancher* case and stated that it was clear that "*Gancher* is correctly decided", 171 F. Supp. 490, 495.

It is evident from the above recital of facts that the *Rafal* case is easily distinguishable from the captioned case by the fact that Rafal worked 48 hours a week devoting his full time to the partnership and by the fact that Rafal's salary was paid from the profits of the partnership. In the instant case the corporation which paid appellant showed a net loss for the 18 months in question and there can be no finding of bona fide service rendered to the corporation in the same manner or of the same type rendered by Rafal.

In *MacPherson v. Ewing,* 107 F. Supp. 666 (N.D. Cal., 1952) the employer and employee were strangers

who were dealing with each other at arm's length. In the instant action, however, the payments in question were made between a corporation controlled by the claimant and the claimant herself. *MacPherson* cannot possibly be made to stand for the proposition that, where the claimant is an employee of a corporation that she controls, transactions between the two parties may not be carefully scrutinized in order to determine whether there existed more than mere bookkeeping entries motivated by the coverage requirements of the Social Security Act.

Thorbus v. Hobby, 124 F. Supp. 868 (S.D.Calif., 1954), affirmed *sub nom. Folsom v. Poteet,* 235 F. 2d 937 (C.A. 9, 1956) is also unlike the instant action. In that case the Court of Appeals found that "Thorbus rendered many, many services to the tenants not associated with merely acting as lessor of an apartment to a tenant. * * * Thorbus did give, in our judgment, sufficient service of the hotel variety at his office, in the halls and at the doors of his tenants to bring him within the department's regulations for coverage under the statute." 225 F. 2d 937, 938. The many services which Thorbus rendered in what was essentially a hotel operation are set out in the District Court's opinion, 124 F. Supp. 868, 870 to 871. None of the services which plaintiff rendered on behalf of her corporation could be said to in any way match the services rendered by Thorbus.

The creation and existence of a corporation has also been disregarded in other cases involving claims for social security benefits. See the case of *Howatt v. Folsom,* 160 F. Supp. 490 (E.D.Pa. 1957), affirmed

253 F.2d 680 (3 Cir. 1958), wherein the plaintiffs unsuccessfully attempted to use the corporate device to circumvent the exclusion of family employment from covered employment under the Act (section 210(a)(3) of the Act, 42 U.S.C.A. 410(a)(3)). See also *Greenberg v. Folsom,* Civil Action No. 135333, U.S.D.C. E.D. N.Y., rendered on March 20, 1959 (unreported) which incorporated the court's earlier decision in that case, C.C.H., U.I.R., Vol. 1, Fed. para. 506.65. In that case, the administrative decision denying benefits to the plaintiff was upheld where the plaintiff had formed a corporation and then purported to pay herself a salary to write a book and sell real estate.

It is well settled that a corporate entity may not be used as a device for circumventing legislative policy. For example, in *Anderson v. Abbott,* 321 U.S. 349, 64 S.Ct. 531 (1944), the Supreme Court said (pp. 362-363):

> "* * * It has often been held that the interposition of a corporation will not be allowed to defeat a legislative policy, whether that was the aim or only the result of the arrangement. * * * The Court stated in Chicago, M. & St. P. Ry. Co. v. Minneapolis Civic & Commerce Ass'n, supra, 247 U.S. page 501, 38 S.Ct. page 557, 62 L.Ed. 1229, that 'the courts will not permit tremselves to be blinded or deceived by mere forms of law' but will deal 'with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.' * * *"

See also *Moline Properties, Inc. v. Com'r. of Int. Rev.,* 319 U.S. 436, 63 S. Ct. 1132 (1943).

When the activities involved in the instant matter are scrutinized, they are revealed to be without substance and must be disregarded, if the Social Security Act and the legislative intent underlying it are to have any meaning. As the referee pointed out, the Social Security Act was designed to replace lost earnings of individuals who have retired from their labors. Indeed, from its inception, the Federal program for old-age and survivors benefits was planned for the purpose of underwriting some of the economic hazards of old age by providing a partial replacement for the earnings lost by individuals upon their retirement. Thus, in the Report of the Committee on Economic Security in 1935, the recommendation was made (at page 4):

> "To meet the problem of security for the aged we suggest as complementary measures non contributory old-age pensions, compulsory contributory annuities, and voluntary contributory annuities, *all to be applicable on retirement at age 65 or over.*" (Emphasis supplied.)

The concept that rights to benefits are accumulated on the basis of activities which demonstrate a capacity for earnings has been reiterated continually by the legislative bodies which have been concerned with the establishment and the development of the program. See, for example, the report of the Committee on Ways and Means (Report No. 615, 74th Congress, 1st Session, 1935, at page 19):

> "This title provides for the payment of cash benefits to every individual who has attained the age of 65 and has fulfilled certain qualifications.

> These benefits will be paid to him monthly as long as he lives in an amount *proportionate to the total amount of wages received by him for employment* before he attained the age of 65." (Emphasis supplied.)

(See also report of the Senate Committee on Finance (Report No. 628, 74th Congress, 1st Session, 1935, at page 31).)

This same philosophy of the Act is reflected in Senate Report No. 1669 (81st Congress, 2nd Session) wherein the Senate Finance Committee recommended a broad extension of the coverage provisions to include under the system the self-employed as well as previously excluded groups of employees. The report states:

> "We believe that improvement of the American social-security system should be in the direction of preventing dependency before it occurs, and of providing more effective income protection, free from the humiliation of a test of need."

Accordingly, the committee recommended action designed to immediately bolster and extend the system of old-age and survivors insurance by extension of coverage, increasing benefit amounts, liberalizing eligibility requirements, and otherwise improving this basic system for dealing with income losses.

It is thus apparent that the purpose of the Act in all respects is to provide a partial replacement of the moneys earned by one actively pursuing employment or self-employment, when that active pursuit is terminated by age. The appellant in this case has not

lost any earnings due to retirement because she has never had any bona fide wages or creditable self-employment income. She has at all times received only rental income which is specifically excludable by section 211(a)(1) (42 U.S.C.A. 411(a)(1)) of the Act from net earnings from self-employment creditable for social security purposes. She has merely attempted to convert her excludable rental income into creditable wages by manipulating her funds from one account to another. Moreover, the appellant has not really even given up her property because she remains the sole stockholder in the corporation which now has title to the farm and the duplex property.

If the appellant's scheme is allowed to succeed it will defeat not only the Congressional intent underlying the coverage provisions of the Act, but also the deductions from benefit provisions of the statute. Section 203(b) of the Act (42 U.S.C.A. 403(b)) provides that, when an individual's claim has been determined and he has been awarded benefits, deductions may nonetheless be made from such benefits if he thereafter realizes certain minimum "earnings." "Earnings" for this purpose is defined in section 203(e)(4)(A) and (B) (42 U.S.C.A. 403(e)(4)(A) and (B) as "the sum of his wages for services rendered" plus "his net earnings from self-employment." These deductions provisions further carry out the basic philosophy of the Act which is to replace lost earnings. The appellant who has retired from her "salaried" positions, still remains the sole stockholder of the corporation and, as such, she could in the future purport to receive her rental income as dividends from the corporation

and thus escape deductions from any benefits which might be awarded to her. In reality nothing will have changed. The appellant at all times has, and will have, received rental income from her farm and duplex property. Her artifices clearly contravene the purposes of the Social Security Act in every conceivable way.

In the instant case the referee was faced with a situation which has arisen many times since the Social Security Act was amended in 1950, effective January 1, 1951, so as to provide for a so-called "new start" which enabled many elderly persons to gain insured status with only 6 "quarters of coverage." Thus, many persons saw an opportunity to realize a substantial return on a small investment, by paying a small amount of purported social security taxes for a few months with the hope of thereby obtaining old-age insurance benefits for the remaining years of their lives. Various schemes of contrived coverage have been resorted to, and when the facts of these contrived cases are analyzed in accordance with the various criteria for determining a valid employer-employee relationship, it clearly appears, as here, that the purported employment relationship falls far short of the legal requirements for such a relationship.

The appellant in this case who was recently widowed and was over age 65 when the arrangement in question was entered into, has attempted to augment her income by the payment of a nominal amount of social security taxes for a short period of time. An analysis of the facts shows that the corporation was formed for no

other purpose than to serve as a conduit for the appellant's funds and that no bona fide employment relationship was ever intended or entered into.

The Social Security Administration does not have the burden of proving that a person claiming benefits is not entitled thereto. Congress has prescribed, as to each category of benefits under the Act, the conditions which must be met for entitlement to such benefits. Although the Administration does not consider itself to be, and does not act as, an adversary of a claimant for benefits, it cannot allow a claim where the evidence does not affirmatively establish that the prescribed conditions of entitlement have been met. Moreover, even apart from the provisions of the Act, it is well settled that the burden of proof rests upon the one who files a claim with an administrative agency to establish that the required conditions of eligibility have been met. *Norment v. Hobby,* 124 F. Supp. 489 (N.D.Ala. 1953); *Thurston v. Hobby,* 133 F. Supp. 205 (W.D.Mo. 1955); both involving claims for social security benefits. See also *Eschbach v. Contractors, Pacific Naval Air Bases,* 181 F.2d 860 (7 Cir. 1950); *Ashford v. Appeal Board,* 238 Mich. 428, 43 N.W.2d 918 (1950); *Department of Industrial Relations of the State of Alabama v. Tomlinson,* 251 Ala. 144, 36 So.2d 496 (1948) (in which the Alabama supreme court held, citing a number of decisions by courts of other States also holding, that a claimant under a State unemployment compensation law has the burden of proof to establish his right to benefits, and that *"The claimant assumes the risk of nonpersuasion"* (emphasis supplied)).

The decision rendered by the referee is supported by the terms of that part of section 205(g) of the Social Security Act (42 U.S.C.A. 405(g)), which reads: "The findings of the Secretary as to any fact, if supported by substantial evidence, shall be conclusive." This is fully recognized by numerous cases which arose and were decided under title II of the Social Security Act, including the following: *United States and Social Security Board v. LaLone,* 152 F.2d 43 (9 Cir. 1945); *Rosewall v. Folsom,* 239 F. 2d 724 (7 Cir. 1957); *Teder v. Hobby,* 230 F.2d 385 (7 Cir. 1956); *Walker v. Altmeyer,* 137 F. 2d 531 (2 Cir. 1943); *Social Security Board v. Warren,* 192 F.2d 974 (8 Cir. 1944); *Ferenz v. Folsom,* 237 F.2d 46 (3 Cir. 1956), certiorari denied 352 U.S. 1006; *Hobby v. Hodges,* 215 F. 2d 754 (10 Cir. 1954); *Folsom v. O'Neal,* 250 F.2d 946 (10 Cir. 1957).

These cases also show that the finality accorded by the Act to the administrative findings extends not only to the evidentiary or basic facts, but also to ultimate findings drawn therefrom as inference or conclusion. As stated by the United States Court of Appeals for the Ninth Circuit in *United States and Social Security Board v. LaLone,* supra:

> "Under this section of the Social Security Act providing for appeals from an administrative board, as under the other similar acts, the board's findings of fact must be sustained if the court finds they are supported by substantial evidence. This same finality extends to the board's inferences and conclusions from the evidence if a substantial basis is found for them. * * *"

Even if there were no disputes as to the evidentiary facts, the court could not substitute its own inferences or conclusions for those of the referee. *Livingstone v. Folsom,* 234 F. 2d 75 (3 Cir. 1956); *Walker v. Altmeyer,* supra; *Social Security Board v. Warren,* supra. In *Thurston v. Hobby,* supra, the court said inter alia:

> "A rule of adjective law is that *uncontroverted evidence is not necessarily conclusive of the existence of fact if analysis of surrounding circumstances leaves the mind in a state of conjecture;* under such circumstances its weight and credibility are left to the trier of the facts. * * * [Citing cases.]
>
> *Uncontradicted testimony need not be accepted by a trier of facts as true, where there is something in the evidence or in the tale, itself, which furnishes a basis for discrediting it because of its inherent improbabilities.* Therefore, in the instant review proceeding, it would appear that if the inference and conclusions reached by the Appeals Council are permissible ones on the record made, we have no duty other than to affirm it, even though we might have reached a different conclusion if it had been submitted to us in an original proceeding."

The case of *Larmay v. Hobby,* 132 F. Supp. 738 (D.C.E.D. Wisc. 1955) is particularly in point as delineating the meaning of the term "substantial evidence," and the Court therein also discussed the duty and prerogative of the Secretary to determine the credibility of the witnesses and the sufficiency of the evidence. In that case, the court said:

"* * * Certainly if this matter were before a jury on testimony and return of the defendant, a court could not direct a verdict. It would at least present an issue of fact. The test of substantiality involves such relevant evidence as a reasonable mind would accept as adequate to support a conclusion, * * * [Citing cases.] 'Substantial' evidence means enough evidence to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury. [Citing cases.]

* * * * * * *

"In any event, *the credibility of the testimony of a witness is to be judged upon the basis of those inconsistencies as well as the means of the witness' information and interest in the suit.* United States v. Ybanez, C.C., 53 F.536. Also the case of Lee Sing Far v. U. S., 9 Cir., 94 F. 834, pronounces the rule that *it is for the Referee to determine the credibility of the witness and the sufficiency of the evidence.* The Judgment to credibility is made among other criteria *upon the basis of the probability of the story* with reference to the witness' opportunity to observe the facts testified *and his interest in the proceeding.*" (Emphasis supplied.)

For a discussion of the scope of judicial review that is within the power of the district court in an action under section 205(g) of the Social Security Act see the district court's decision in the recent case of *Carqueville v. Folsom,* 170 F. Supp. 777 (N.D. Ill. 1958) wherein the court affirmed the referee's decision denying the plaintiff's claim for benefits. See also the opinion of the Court of Appeals for the Seventh Cir-

cuit, 263 F. 2d 855, rendered on January 15, 1959, wherein the decision of the district court was upheld.

In conclusion, the appellee submits, that even apart from the substantial evidence rule, it is clear that on the basis of the evidence in this case, the referee was amply warranted in finding, and that he correctly found that no employment relationship existed between the appellant and the corporation.

Therefore the judgment of the district court should be affirmed.

Dated, San Francisco, California,
July 26, 1960.

Respectfully submitted,

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NO. 16816

United States
COURT OF APPEALS
for the Ninth Circuit

PORTLAND BASEBALL CLUB, INC., an Oregon corporation,

Appellant,

vs.

FORD C. FRICK, COMMISSIONER OF BASEBALL, et al,

Appellees.

APPELLANT'S BRIEF

Appeal from the United States District Court for the District of Oregon.

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APPELLANT'S BRIEF

Appeal from the United States District Court for the District of Oregon.

BASIS OF JURISDICTION

Plaintiff filed this suit (R. 3) to recover damages and certain equitable relief for violations of the Sections 15 and 26 of Title 15 U.S.C., being part of the act of Congress of July 2, 1890, entitled "AN ACT TO PROTECT TRADE AND COMMERCE AGAINST UNLAWFUL RESTRAINT AND MONOPOLY," as amended, and commonly known as the Sherman Act and Clayton Act.

The action is to recover damages and equitable relief against the defendant for injuries to the plaintiff in its business of conducting exhibitions of baseball in Portland, Oregon, and in seven other cities constituting the Pacific Coast League, which injury proximately resulted from defendant's violation of anti-trust laws of the United States. The complaint alleges that the defendants herein have continuously engaged in and transacted business in the State of Oregon by their scouting activities, by their ownership of clubs that participate in the Pacific Coast League and particularly in Portland, Oregon, by working agreements in the same manner, by the televising of baseball games into the State of Oregon and by subsidizing of clubs by the defendants in the State of Oregon (R. 4-9).

On December 14, 1959, the Honorable Gus J. Solomon, Judge of the District Court, entered an order dismissing plaintiff's complaint for want of jurisdiction (R. 81). On the 5th day of January, 1960, plaintiff filed its Notice of Appeal (R. 83). This Court has jurisdiction by virtue of the provisions of 28 U.S.C.A., Sec. 1291.

STATEMENT OF CASE

This is a suit based upon the violations of the provisions of the Sherman and Clayton Acts aforesaid. The plaintiff is one of eight teams having membership in the Pacific Coast League, a league that has been in existence for over fifty years. The complaint alleges that the plaintiff operates within the organization known as "Organized Baseball," Organized Baseball being predicated on an

agreement between the sixteen Major League Teams and the Minor League teams; said agreement being known as the "Professional Baseball Agreement" and sometimes referred to as the "Major-Minor Agreement" (R. 57-69). This agreement sets forth the conditions and obligations of the working agreements; the drafting of ball players, the number of players that each team can have and all the interworkings of baseball. The sixteen defendants, known as the Major League teams, in their organization under the Major-Minor Agreement have a rule that each club can own only forty ball players. By their monopolistic practices, the defendants have done great damage to the plaintiff in its operation of its baseball team.

The alleged monopolistic practices consist of (R. 16-31):

1. The ownership by the sixteen Major League defendants of practically all of the baseball talent and, particularly, the young baseball talent; that the plaintiff is unable to acquire young baseball talent because of the monopolistic practices of these said sixteen defendants.

2. Excessive and illegal telecasting of Major League baseball into Minor League territory in violation of the Professional Baseball Agreement, and preventing the telecasting of Major League games into Major League territory.

3. Infiltration into the Minor League organization of men paid by or under obligation to the defendants.

4. Complete domination of the Minor Leagues, not only in the acquisition of, but use, recall, buying and selling and trading of player talent.

By the aforesaid practices the plaintiff has been damaged in reduction of attendance and even though the metropolitan area of the City of Portland has become a larger area, the plaintiff is deprived of growing and satisfying the desire of said growing metropolitan area by any improved brand of baseball because of the practices of these defendants.

The plaintiff and practically all Minor League teams are in an increasingly weakened position and will continue to be so unless the practices are declared to be improper and these defendants are enjoined from their monopolistic practices.

SPECIFICATION OF ERROR

The Court erred in granting defendants' motion to dismiss plaintiff's Complaint.

SUMMARY OF ARGUMENT

The applicable statute simply states that every contract or combination, in the form of trust or otherwise, in restraint of trade or commerce among the several states is declared to be illegal. The Congress passed this law under the commerce clause; it is all inclusive and there are no exceptions. The defendants are either bound by the above-mentioned law or they are not. Other similar activities or professional sports are bound and there is no basis for distinction that would grant immunity to these defendants.

ARGUMENT

Amount of Commerce

It seems unnecessary to argue whether baseball has sufficient quantum of interstate activity to be declared to be interstate commerce. The language of the Supreme Court in *Radovich vs. National Football League,* 352 U.S. 445, is as follows, p. 451:

> "If this ruling is unrealistic, inconsistent or illogical, it is sufficient to answer, aside from the distinctions between the businesses, that were we considering the question of baseball for the first time upon a clean slate we would have no doubts."

It is generally agreed that, if the allegations against the defendants were being presented for the first time, there would be no question that the acts complained of would be subject to the Antitrust laws.

The decision of Justice Holmes in *Federal Baseball Club v. National League,* 259 U.S. 200, however has been interpreted to give baseball immunity. The decision has been adhered to only as to baseball, but not any other sport or entertainment, whether team or individual. (*U.S. v. Shubert,* 348 U.S. 222; *Toolson v. New York Yankees,* 346 U.S. 356; *U.S. v. International Boxing Club,* 348 U.S. 236; *Radovich v. National Football League,* 352 U.S. 445.)

Analysis of Toolson Decision

The Supreme Court in this decision reaffirmed its earlier holding that professional baseball is not subject to the Anti-trust laws.

The Court observed that subsequent to the *Federal Baseball* decision, which established this sport's exemption from the Anti-trust laws, on p. 357:

> "Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing anti-trust legislation."

"Without reexamination of the underlying issues," the court reaffirmed its holding in the *Federal Baseball* case, "so far as that decision determines that Congress had no intention of including the business of baseball within the scope of Federal Anti-trust laws."

Mr. Justice Burton dissented from this holding and Justice Reed concurred with him. These Justices were of the opinion that organized baseball is now engaged in interstate commerce and, therefore, subject to the Anti-trust laws. The dissenting Justices said on p. 357:

> "* * * in the light of organized baseball's well known and widely distributed capital investments used in conducting competitions between teams constantly traveling between states, its receipts and expenditures of large sums transmitted between states, its numerous purchases of materials in interstate commerce, the attendance at its local exhibitions of large audiences often traveling across state lines, its radio and television activities which expand its audiences beyond state lines, its sponsorship of interstate advertising, and its highly organized 'farm system' of minor league baseball clubs, coupled with restrictive contracts and understandings between individuals and among clubs or leagues playing for profit throughout the United States and even Canada, Mexico and Cuba, it is a contradiction in terms to say that the

> defendants in the cases before us are not now engaged in interstate trade or commerce as those terms are used in the Constitution of the United States and in the Sherman Act, * * *"

Professional baseball, stated Justices Burton and Reed, "is interstate trade or commerce and, as such it is subject to the Sherman Act until excepted."

The *Toolson* case relied on the *Federal Baseball* case. If it is good law, it must be because the earlier case is good law.

Therefore, since this famous decision is the basis for the Supreme Court's latest decision on baseball, the case should be carefully reviewed to see (1) if the Court intended all the immunities read into that decision and (2) if the decision is a sound one and one that should be followed?

Analysis of Federal Baseball Case

As to point number 1, it is seriously urged that Justice Holmes did not intend his decision to be so all embracing as to exclude baseball regardless of how big or how extensive its operation became.

In the case of *Hart v. Keith Vaudeville Exchange,* 262 U.S. 271, which was handed down just a year later, it seems that Justice Holmes was intending to limit and restrict his remarks of a year earlier.

In the *Hart* case the plaintiff sought relief of the court prior to the decision of the United States Supreme Court in the *Federal Baseball* case against an alleged conspiracy

of theatre owners engaged in the business of getting contracts for vaudeville actors to perform throughout the United States and of acting as their managers and personal representatives, alleging that the business involved contracts not only for travel of performers from state to state and from abroad, but also for transportation of vaudeville acts including performers, scenery, music, costumes, etc., resulting in a constant stream of commerce from state to state, in which plaintiff claimed the apparatus transported was not a mere incident, but sometimes more important than the performers.

The Court held that the case came within the Anti-trust Act, and, on page 274, stated: "The bill was brought before the decision of the *Baseball Club* case, and it may be that *what in general is incidental, in some instances may rise to a magnitude that requires it to be considered independently.*"

Thus, to construe the Holmes decision to give baseball a blanket release is not justified in light of his remarks in the Hart decision a year later.

The scope of the operation of baseball has changed immensely since 1922 (R. 12-16). The operation of farm clubs, working agreements, acquisition of players far beyond their immediate needs, an elaborate scouting system, and the transmission of the game by radio and television to all the states and some foreign countries has certainly taken baseball out of the "sport" category and made its interstate activity one of a "great magnitude." Certainly those elaborate operations cannot be described as "incidental."

We are dealing with men engaged in a professional activity at very lucrative salaries---this, too, has changed since the 1922 decision. The word "sport" is usually and originally thought of where a group of participants engaged in some athletic endeavor for the honor of their Alma Mater, their home town, etc. But now the sports angle is reduced considerably by the participants demanding and being offered the highest bid possible. Teams are shifted from week to week because, to the defendants, winning is the prime goal. Ethical standards are being shoved in the background. It is the Major League defendants who are unduly emphasizing the materialistic considerations and de-emphasizing the sportsmanship phase of the game.

It is the Minor Leagues who are truly devoted to baseball. At the present time because of the practices and activities of the defendants, a Minor League franchise is a license to lose money. But many men devoted to the wonderful attributes of the game of baseball struggle along because they firmly believe, as does the plaintiff, that baseball is a wonderful and constructive force for every community.

Professional sports can conduct themselves in such a manner that the same altruism that exists in amateur sports can be maintained, but the plaintiff and those engaged in the professional activity should not attempt to delude themselves or the courts that they are not part of the business world and not subject to the same rules as other people in the market place.

As to point number 2, — is the Federal Baseball doctrine a sound legal proposition to follow?

We believe that the decision as construed is wrong and should be overruled. Furthermore, the decisions interpreting it have extended the doctrine far beyond its original intention. Let us examine the facts of that decision.

The plaintiff and seven other baseball clubs comprised the Federal League of Professional Baseball. The Supreme Court held that, on p. 208:

> "The business is giving exhibitions of baseball, which are purely state affairs. It is true that in order to attain for these exhibitions the great popularity that they have achieved, competitions must be arranged between clubs from different cities and states. But the fact that in order to give the exhibitions the Leagues must induce free persons to cross state lines and must arrange and pay for their doing so is not enough to change the character of the business. According to the distinction insisted upon in Hooper vs. California, 155 U.S. 648, 655, 15 Sup. Ct. 207, 39 L.Ed. 297, the transport is a mere incident, the exhibition, although made for money would not be called trade or commerce in the commonly accepted use of the words. As it is put by the defendant, personal effort, not related to production, is not a subject of commerce. That which in its consummation is not commerce does not become commerce among the States because the transportation that we have mentioned takes place. To repeat the illustrations given by the Court below, a firm of lawyers sending out a member to argue in a case, or the Chautauqua lecture bureau sending out lecturers, does not engage in such commerce because the lawyer or lecturer goes to any other State.
>
> "If we are right the plaintiff's business is to be described in the same way and the restrictions by contract that prevented the plaintiff from getting players to break their bargains and the other con-

duct charged against the defendants were not an interference with commerce among the States."

The following statements were made in that decision:

(1) "The decision of the Court of Appeals went to root of the case * * *" P. 208.

(2) "According to the distinction insisted upon in *Hooper v. California* the transport is a mere incident, not the essential thing." P. 209.

(3) "But we are of the opinion that the Court of Appeals was right." P. 208.

(4) "To repeat the illustrations given by the Court below * * *" P. 209.

Those statements clearly indicate that the Supreme Court adopted the reasoning of the Court of Appeals. Consequently, we must go back to decision of the Court of Appeals, 269 F. 681, and analyze that opinion to see what the reasoning and authorities are in order to determine if that decision is still good law, and also if the authorities cited are still good law.

At 269 F. 685, the Court states: "The production of the game was the dominant thing in their activities." This followed *Hooper v. California,* 155 U.S. 648, in which the Supreme Court of the United States had been asked to hold that, because an insurance corporation, in effecting a marine insurance policy, used some instrumentalities of commerce, it was engaged in that commerce. The Court had refused to yield to the argument, and said:

> "It ignores the real distinction upon which the general rule and its exceptions are based, and which consists in the difference between interstate commerce, or an instrumentality thereof, on the one side,

> and the mere incidents which may attend the carrying on of such commerce on the other."

The Court held that the business of marine insurance was not commerce irrespective of the fact that some of its incidents were. (Consult also *Paul V. Virginia,* 75 U.S. (8 Wall) 168; *New York Life Ins. Co. v. Cravens,* 178 U.S. 389.) By analogy, baseball was held not to be commerce, though some of its incidents might be.

The case of *U.S. v. South-Eastern Underwriters Assn.,* 322 U.S. 533, has erased the authorities on which the Court relied and consequently the main support of the Court of Appeals decision is no longer the law.

On page 685 the Court further states: "The fact that the appellants produce baseball games as a source of profit, large or small, cannot change the character of the game. They are still sport, not trade."

The Court then goes on to cite several cases involving the booking and producing of theatrical performances, principally *In Re Oriental Society, Bankrupt,* 104 F. 975, and *People v. Klaw,* 106 N.Y.S. 341 (1907). These cases have been rendered obsolete by the *Hart v. Keith* decision, 262 U.S. 271, and *U.S. v. Shubert,* 348 U.S. 222.

On page 686 the Court states:

> "In the American Baseball Club case the precise question we are considering was passed upon in a carefully prepared opinion, and it was held that the production of exhibitions of baseball did not constitute trade or commerce. The National Agreement, the rules and regulations adopted pursuant to it and the players contracts complained of in this suit, were all considered by the Court in reaching its conclusion."

If we check that authority, *American Baseball Club of Chicago v. Chase,* 149 N.Y.S. 6, we find that it was based principally on *U.S. v. E. C. Knight,* 156 U.S. 13, also obsolete.

In the case of *People v. Klaw,* 106 N.Y.S. 341, cited by the Court of Appeals, the part of the opinion that discusses "Commerce," stresses the authority of *Paul v. Virginia, Hooper v. California,* and *N.Y. Life Ins. Co. v. Cravens*—all these authorities have been rendered obsolete.

Consequently the premise—logic—reasoning and basic foundation of the Federal Baseball case is completely undermined, and should not be followed.

The Court stated in *U.S. v. Shubert,* 348 U.S. 222:

> "At the very next term in Hart v. B. F. Keith Vaudeville Exchange, 262 U.S. 271, the Court was directly concerned with the effect of the Federal Baseball case decision on the status of the theatrical business under the Sherman Act. The complaint in the Hart case, much like the complaint here under review, alleged a conspiracy to control the booking and presentation of vaudeville acts by theatres throughout the country. * * *"

The Court thus established, contrary to defendants' argument here, that the Federal Baseball case did not automatically immunize the theatrical business from the anti-trust laws. At p. 230:

> "This Court has never held that the theatrical business is not subject to the Sherman Act. On the contrary, less than a year after the Federal Baseball decision, the Court in the Hart case put the theatrical business on notice that Federal Baseball could not be relied upon as a basis for exemption from the Anti-trust laws. * * *"

The decision of Justice Holmes has erroneously been interpreted to mean that baseball has immunity. It should be restricted to mean that baseball only was granted immunity as long as the interstate features were "incidental." Certainly the scope of "modern baseball" cannot be compared to 1920 baseball without coming to the conclusion that the same thing has happened to baseball that has happened to the corner grocer. Baseball is run on a supermarket tempo, and has all the aspects of any multi-state business.

This case involves the entire structure and procedures of baseball, including:

1. Player acquisition.
2. Elaborate nationwide scouting.
3. Transmission and control by Radio and Television.
4. Farm Club and Working Agreements throughout most of the States.
5. Related business activities on a large scale—such as concessions and leasing of stadium.
6. Control of the entire government of "organized baseball."

This is an entirely different set of facts from Federal Baseball, and the Hart case, the Shubert case and the Radovich case should be followed.

Comment on Toolson Decision

The court on page 357 states:

> "Without re-examination of the underlying issues, the judgments below are affirmed on the authority of Federal Baseball Club * * * so far as that decision

> determines that Congress had no intention of including *the business of baseball* within the scope of the federal Antitrust laws."

When the Court in *Federal Baseball* started all this immunity it restricted it as follows, 259 U.S., p. 208:

> "The business is giving exhibitions of baseball, which are plainly State affairs."

And concluded by saying, p. 209:

> "If we are right the plaintiff's business is to be described in the same way and the restrictions by contract that prevented the plaintiff from getting players to break their bargains and the other conduct charged against the defendants were not an interference with commerce among the States."

The Court was principally concerned with the question of the reserve clause in both those cases. The Court decision can be construed to be only an immunity of baseball as it was carried on at that time. Certainly the broadening of the entire base of their operations to include nation-wide activities cannot be measured by the same measuring stick as used in 1922.

To accept the construction that Toolson and Radovich give baseball blanket immunity could lead to some ridiculous and embarrassing situations. Could the defendants operate a bat factory and sell in interstate commerce and be immune? Baseball is subject to obedience under the law just as much as anyone else and to say that one activity, larger in scope than other activities, is immune and the others are not is to make a mockery out of the system of justice and bring about disrespect for such arbitrary and frivolous distinctions. How can the public

or lawyers have any faith in the consistency of enforcement of these laws or faith in the equal protection of the laws if such interpretations are allowed to continue?

Analysis of Radovich Decision 352 U.S. 445 (1957)

This action sought damages and injunctive relief testing the application of the Anti-trust laws in the business of professional football. Radovich, the plaintiff, a professional football player, contended that the members of the National Football League entered into a conspiracy to monopolize and control organized professional football and in particular caused him to be boycotted from coaching and playing for the San Francisco Clippers in the Pacific Coast League.

The United States Supreme Court held that professional football is subject to the Anti-trust laws. The majority of the Court also held that the 1922 decision in the *Federal Baseball* case was of dubious validity and the Court had only followed it in the Toolson case because, p. 450:

> "Vast efforts had gone into the development and organization of baseball since that (Federal Baseball) decision and enormous capital had been invested in reliance on its permanence."

Further, p. 450-451:

> "Congress had chosen to make no change. All this, combined with the flood of litigation that would follow its repudiation, the harassment that would ensue, and the retroactive effect of such a decision, led the Court to the practical result that it should sustain the unequivocal line of authority reaching over many years."

But the Toolson decision, said the majority, in the Radovich case, was carefully restricted to baseball and is not authority, p. 451:

> "* * * for exempting other businesses merely because of the circumstances that they are also based on the performance of local exhibitions. * * *"

The crux of the *Federal Baseball* case, according to the Radovich opinion, was the limited degree of interstate activity in baseball. But "the volume of interstate business involved in organized football places it within the provisions of the (Sherman Antitrust) Act." P. 452:

> "If this ruling is unrealistic, inconsistent, or illogical, it is sufficient to answer, aside from the distinctions between the businesses, that were we considering the question of baseball for the first time upon a clean slate we would have no doubts. But the *Federal Baseball* case held the business of baseball outside the scope of the Act. No other business claiming the coverage of these cases has such an adjudication. We, therefore, conclude that the orderly way to eliminate error or discrimination, if any there be, is by legislation and not by Court decision."

Should This Court Follow Radovich or Toolson?

The Court below took the position that neither he nor this Court could "overrule" the Supreme Court, and that he must therefore follow the Toolson decision in holding that baseball is exempt from the operation of the antitrust laws. We respectfully submit that, despite the attempt of the Supreme Court to distinguish the two factual situations, the Radovich decision has left nothing to be followed in the Toolson case.

The Toolson case proceeded upon the premises that

baseball had relied upon the decision in the Federal Baseball case, that substantial capital investment had been made on the assumption that the rule of that case would be followed, and that Congress, by its inaction, had demonstrated an intention to approve the rule of the Federal Baseball decision. The inaccuracy of these premises is demonstrated by the Radovich decision, because there is not a word in the Federal Baseball decision which is not as applicable to football as it is to baseball.

Thus, if professional baseball relied upon the holding that the giving of local exhibitions is not commerce, professional football and all other professional sports relied equally; if capital was invested in baseball upon the assumption that the Federal Baseball case stated the law once and for all, the same reliance applied to all other sports; and if Congress, by its inaction, approved the rule of the Federal Baseball case, it approved it as to all sports, and not merely as to baseball.

The Radovich case exposes another fallacy in the argument with reference to Congressional intent. The Toolson case stated that "The business has thus been left for 30 years to develop on the understanding that it was not subject to existing anti-trust legislation." But "existing" anti-trust legislation, as the Supreme Court has frequently held, exhausted the power of Congress to legislate. As the Court said in *Atlantic Cleaners and Dyers v. U.S.*, 286 U.S. 427, 434:

> "A consideration of the history of the period immediately preceding and accompanying the passage of the Sherman Act and of the mischief to be remedied, as well as the general trend of debate in both houses,

> sanctions the conclusion that Congress meant to deal comprehensively and effectively with the evils resulting from contracts, combinations and conspiracies in restraint of trade, and to that end to exercise all the power it possessed."

See also, *Apex Hosiery v. Leader,* 310 U.S. 469, 495; *U.S. v. Frankfort Distilleries,* 324 U.S. 293, 298, and *U.S. v. South-Eastern Underwriters Assoc.,* 322 U.S. 533, 538, 550.

The reason why Justice Holmes, in the Federal Baseball case, held that baseball was exempt from the anti-trust laws, was not that Congress, in its all-inclusive language in the Sherman Act, had failed to cover any aspect of commerce, but because baseball was not interstate commerce. Thus, following that holding, Congress could not constitutionally pass any legislation. And since, as above noted, Congress has already exhausted its power to legislate over interstate commerce, either existing anti-trust legislation covers baseball, and other professional sports, or Congress cannot constitutionally legislate with respect to them. The Supreme Court, however, has held that Congress not only can, but has, included professional sports within the scope of the anti-trust legislation, and since baseball is not exempted, it must follow that it is covered.

There is nothing in the Federal Baseball decision which holds that there is something peculiar about baseball which prevents it from coverage under the anti-trust laws no matter how big a business it becomes. It merely holds that the facts shown in that case with respect to interstate activities were incidental to the local nature of the

business. But the Radovich case establishes that such is no longer the case. Baseball has changed, and is now interstate commerce, even if it was not when the Federal Baseball decision was rendered.

Finally, if baseball is exempt from the anti-trust law, what protection is there to those elements of baseball, including plaintiff, which are not a part of the monopolistic conspiracy alleged in plaintiff's complaint? Certainly no one will argue that the states can constitutionally legislate in this area, or that they have the power to cure the evil, even if they can constitutionally affect the situation. The Supreme Court in Toolson expressed concern over the harassment of the major leagues which would follow in the wake of a reversal of the Federal Baseball doctrine, but what of the harassment of the minor leagues which continues to exist in view of the Congressional impasse on the subject? The decision in the Radovich case has not made it impossible for professional football to operate. Congress has not acted, either to exempt or include professional sports. The present situation is not only intolerable, but absurd. Since no distinction exists in the applicable statutes, for this Court to hold that the Radovich case did not overrule the Toolson decision would be to hold that there is a distinction between the game of baseball and all other games which is imbedded in the Constitution of the United States. We respectfully submit that such an intent cannot be imputed to the Founding Fathers.

Toolson was decided "without reexamination of the underlying issues." When those issues were examined,

in Radovich, the Federal Baseball decision was found to be unsound. This Court should follow the Radovich case, since it effectively overrules the Toolson decision.

Respectfully submitted,

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No. 16816

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Appellees' Brief

Appeal from the United States District Court
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Appellees' Brief

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for the District of Oregon

JURISDICTIONAL STATEMENT

This is an appeal from an order of the United States District Court for the District of Oregon dismissing the Appellant's Amended and Supplemental Complaint for lack of jurisdiction of the Court over the subject matter of the action and because of failure of the plaintiff to state a claim upon which relief could be granted (R. 82-83).

The original Complaint and the Amended and Supplemental Complaint were filed on August 3,

1959 and November 24, 1959, respectively, under §§15 and 26 of Title 15 U.S.C., being part of the Clayton Act, for alleged violations of the federal antitrust laws. The Appellees, on October 13, 1959, moved to quash the summons issued to them and to dismiss the original Complaint on various grounds, including lack of jurisdiction over the persons of the defendants and over the subject matter (R. 71-76). Upon stipulation of the parties, an order was entered on October 21, 1959, by the District Court that the motions to dismiss the action because of lack of jurisdiction over the subject matter and because of the failure of plaintiff to state a claim upon which relief could be granted, should be segregated and be first heard and determined by the Court before hearing or determination of defendants' other motions (R. 77-80) and this order was later extended by order dated December 14, 1959, to the Amended and Supplemental Complaint (R. 80-82).

This Court has jurisdiction of the appeal by virtue of the provisions of 28 U.S.C. §1291.

STATEMENT OF THE CASE

Appellant is Portland Baseball Club, Inc., which operates a professional baseball club as a member of the Pacific Coast League. Appellees are fifteen corporations, each of which owns and operates a Major League baseball club as a member either of The National League of Professional Baseball Clubs

or of The American League of Professional Baseball Clubs. The Complaint also named as defendants Ford C. Frick, Commissioner of Baseball; New York Yankees, a co-partnership; The American League of Professional Baseball Clubs and its President, Joseph Cronin; and The National League of Professional Baseball Clubs and its President, Warren Giles, none of whom has been served in the action.

The Appellant brought the action for damages and equitable relief for alleged injuries to it in its business of conducting exhibitions of professional baseball claimed to have been caused by defendants' alleged violations of §§1 and 2 of the Sherman Act (15 U.S.C., §§1, 2). The alleged violations of the antitrust laws are stated in considerable detail in the Complaint (R. 16-31), and summarized on page 3 of Appellant's Brief. In further summary, it can be fairly said that the Complaint alleges that Appellant is engaged in the baseball business (R. 4-16), and has been damaged in that business by practices of the defendant Major League clubs in (1) monopolizing baseball players, (2) dominating the Minor Leagues, and (3) telecasting Major League baseball games into Minor League territory (R. 16-31).

The single question presented is whether the federal antitrust laws are applicable to the aspects of the business of baseball to which the allegations of the Amended and Supplemental Complaint relate. The District Court held that this question is

answered by the decision of the Supreme Court in *Toolson v. New York Yankees et al.* (1953), 346 U.S. 356, affirming a decision by this Court and holding that the antitrust laws are not applicable to the business of baseball.

SUMMARY OF ARGUMENT

The United States Supreme Court has directly and consistently held that the federal antitrust laws are not applicable to the business of organized professional baseball. In its latest direct decision on baseball (*Toolson v. New York Yankees et al.*, 346 U.S. 356 (1953)), the Supreme Court had before it three cases which involved all the aspects of the baseball business alleged in the Appellant's Complaint.

Appellant is asking this Court to overrule its own decision and the Supreme Court decision in *Toolson* on the ground that *Radovich v. National Football League*, 352 U.S. 445 (1957), "effectively overrules the *Toolson* decision" (Appellants' Brief p. 21). This argument is conclusively answered by the opinion in *Radovich* which specifically reaffirmed the exempt status of baseball under *Toolson* and reiterated the Court's position that any application of the antitrust laws to baseball should be enacted by new Congressional legislation and not by court decision. As Appellant concedes, "Congress has not acted, either to exempt or include professional sports" (Appel-

lants' Brief p. 20). Since *Radovich,* the Eighty-Fifth and Eighty-Sixth Congresses have considered various bills concerning the status of baseball and other professional team sports under the antitrust laws but have enacted none of them.

ARGUMENT

1. The Supreme Court of the United States has directly and consistently held that the federal antitrust laws are not applicable to the business of organized baseball.

This question has been before the Supreme Court of the United States in four cases. One came to it from the District of Columbia, two from the Sixth Circuit, and one from this Circuit. Collectively, these cases have presented to the Court all of the features of the business of organized baseball here involved. In each case, the Supreme Court held that the business of organized baseball was not within the scope of the antitrust laws.

The Federal Baseball Case (259 U.S. 200)

In *Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs,* 259 U.S. 200 (1922) (hereinafter referred to as the "Federal Baseball case"), the Supreme Court of the United States was first confronted with the question as to whether the Sherman Act is applicable to the business of professional baseball. There, as here, the

plaintiff urged that the business of baseball was subject to the Sherman Act because the clubs engaged in interstate commerce when they crossed state lines with players and equipment in order to play one another. The Supreme Court, in a unanimous opinion written by Mr. Justice Holmes, held that the Sherman Act was not applicable to the business of baseball.

The Toolson Decision
(346 U.S. 356)

In 1951, three Sherman Act suits (*Corbett v. Chandler; Toolson v. New York Yankees;* and *Kowalski v. Chandler*), 346 U.S. 356, were instituted against professional baseball clubs, the Commissioner of Baseball and others. In those suits the plaintiffs severally sought to avoid the *Federal Baseball* case by alleging, as the Portland club here alleges, that the defendants were engaged in interstate commerce and thereby subject to the Sherman Act because, in addition to the essential act of crossing state lines to play one another, the defendants derived substantial income from the sale of rights for nationwide broadcasting and telecasting of games played by their respective clubs and from the sale of interstate advertising rights. In each of the three cases, the trial court dismissed the complaint before trial, and each Court of Appeals, including this Court in *Toolson v. New York Yankees,* 200 F. 2d 198 (1952), affirmed the dismissal.

In 1953, the United States Supreme Court granted certiorari in these cases and they were argued and decided together. (The three cases have become widely known as the Supreme Court's "*Toolson* decision".) In an opinion affirming judgments in favor of the defendants, which had dismissed the actions for lack of jurisdiction of the subject matter and for failure to state a claim upon which relief could be granted, the Supreme Court said in full (346 U.S. 356):

> "In *Federal Baseball Club of Baltimore v. National League of Professional Baseball Clubs,* 259 U.S. 200 (1922), this Court held the business of providing public baseball games for profit between clubs of professional baseball players was not within the scope of the federal antitrust laws. Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation. The present cases ask us to overrule the prior decision and, with retrospective effect, hold the legislation applicable. We think that if there are evils in this field which now warrant application to it of the antitrust laws it should be by legislation. Without re-examination of the underlying issues, the judgments below are affirmed on the authority of *Federal Baseball Club of Baltimore v. National League of Professional Clubs,* supra, so far as that decision

> determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws."

The *Toolson* decision fully covers all of the allegations and arguments made in this action. There, as here, the plaintiffs sought to avoid the *Federal Baseball* decision by stressing baseball's "radio and television activities" and "its sponsorship of interstate advertising" and by arguing that decisions relied upon in *Federal Baseball* had been overruled.* But the Court rejected these contentions and on the authority of *Federal Baseball,* reasserted that the federal antitrust laws are not applicable to the business of baseball.

The allegations in the three cases involved in the *Toolson* decision show striking similarities to the allegations in the complaint in this case. A detailed comparison is set out in the Appendix to this brief. At this point we will briefly describe each of the three cases.

***Corbett v. Chandler* (202 F. 2d 428)**

In 1951, Jack Corbett, then owner and operator of the El Paso Minor League club, instituted an action in the Federal Court for the Southern District of Ohio, against Albert B. Chandler, then Commissioner of Baseball, and others. In that action, Corbett alleged that the agreements and rules of base-

*That all these contentions were considered by the Supreme Court is shown in the dissenting opinion (346 U.S. 357-365).

ball were a restraint on interstate trade and commerce in violation of the Sherman Act, that they deprived him of baseball players under contract to him and prevented him from signing and disposing of others at a profit, and that he had been injured in the operation of his Minor League club. He further claimed the broadcasting, publicity and other channels of communication necessary for and related to the playing of baseball made antitrust laws applicable to those administering and playing the game. He argued in his brief in the Supreme Court that "Organized Baseball maintains its monopoly over the exhibition of professional games within its parks and over radio and television for profit in interstate and foreign commerce through its exclusive control over the market for professional players."

The District Court for the Southern District of Ohio dismissed the action (opinion not reported) and on appeal the decision was affirmed, 202 F. 2d 428 (6th Cir. 1953).

***Kowalski v. Chandler* (202 F. 2d 413)**

Kowalski was a Minor League player who alleged in a Sherman Act action that he had been deprived of an opportunity for promotion and damaged by the Major League clubs' monopolization of baseball and by their operation of their "Farm System" whereby they controlled Minor League clubs. He sought to distinguish his case from the *Federal Baseball* case by alleging facts concerning the sale of

broadcasting rights. The District Court for the Southern District of Ohio dismissed the action for lack of jurisdiction of the subject matter and for failure to state a claim upon which relief could be granted (no opinion reported). The decision was affirmed on appeal, 202 F. 2d 413 (6th Cir. 1953), and the Court of Appeals specifically rejected the broadcasting allegations as a basis for distinguishing *Federal Baseball*. The opinion cited *Toolson* (101 F. Supp. 93) to the same effect.

***Toolson v. New York Yankees* (200 F. 2d 198)**

In 1951, Toolson, a Minor League baseball player, brought an action in the District Court for the Southern District of California for treble damages against the New York Yankees and other baseball parties. He alleged that the defendants had monopolized baseball; that he was a baseball pitcher and was prevented from following that profession by having been placed upon the blacklist. In his amended complaint he also alleged:

> "the defendants and those combined with them in said illegal combination control and own all of the players in professional baseball, control all of the teams in professional baseball and control all of the games and exhibitions thereof, including exhibition by radio and television among the several states of the United States; * * * As a result of such combination the defendant and those combined with them have greatly lessened and eliminated all competition in the

> exhibition of baseball games by broadcasting or televising among the several states; that the place, time, quality of game exhibited, area within which said exhibit is to be sent have been and are strictly controlled by the defendants and by those combined with them in said illegal combination. * * *"

Judge Harrison, in an opinion reported in 101 F. Supp. 93 (S.D. Cal. 1951), dismissed the action both for lack of juridiction of the subject matter and for failure to state a claim upon which relief could be granted. In part, the Court said, at page 95:

> "If the Supreme Court was in error in its former opinion or changed conditions warrant a different approach, it should be the court to correct the error. Trial courts in my opinion should not devote their efforts to guessing what reviewing courts may do with prior holdings because of lapse of time or change of personnel in such courts. We are supposed to be living in a land of laws. Stability in law requires respect for the decisions of controlling courts or face chaos."

This Court, in a *per curiam* opinion, 200 F. 2d 198 (1952), affirmed the decision of Judge Harrison on the grounds stated in his opinion.

The *Toolson* decision, 346 U.S. 356, which decided the three cases summarized above, is the last decision of the Supreme Court dealing directly with the applicability of the Sherman Act to organized professional baseball.

Appellant argues that "modern baseball" cannot be compared to 1920 baseball and that nationwide scouting, radio broadcasting and television, farm clubs and working agreements and related business activities, such as concessions, present a different set of facts from the *Federal Baseball* case (Appellant's Brief, p. 14). To demonstrate that "modern baseball" and all of the claims and subjects in the Appellant's Complaint were fully presented to the Supreme Court in *Toolson,* we have set forth in the Appendix hereto a comparison of the Appellant's Complaint with those in *Toolson, Corbett* and *Kowalski.*

In those three cases, the Supreme Court had before it complaints containing allegations about the monopolization of players, the reserve clause, the Major Leagues' farm systems and their control of Minor League clubs, the radio broadcasting and telecasting of games, interstate travel, national advertising and numerous other details of the baseball business.

The Court's decision in *Toolson* did not concern itself with any such details, but rested on the broad proposition that the "business of baseball" is outside the scope of the antitrust laws. Appellant's Amended Complaint here deals from start to finish with the business of baseball and therefore cannot be sustained without overruling the *Toolson* decision.

2. The *Toolson* decision is controlling here and has not been overruled by *Radovich v. National Football League*, 352 U.S. 445.

Faced with the square holding of *Toolson,* Appellant is forced to argue that this Court should overrule the *Toolson* decision on the ground that *Radovich v. National Football League* (1957), 352 U.S. 445, "effectively overrules the *Toolson* decision" (Appellant's Brief, p. 21).

Without burdening this Court with a detailed analysis of the discussion in Appellant's brief which leads Appellant to this astonishing conclusion, we merely refer to the language of the majority opinion in *Radovich* which makes it crystal clear that *Toolson* is still controlling authority for the proposition that the business of organized professional baseball is not subject to the antitrust laws. The *Radovich* opinion states (352 U.S., at 451-452):

> "It seems that this language would have made it clear that the Court intended to isolate these cases by limiting them to baseball, but since *Toolson* and *Federal Baseball* are still cited as controlling authority in antitrust actions involving other fields of business, we now specifically limit the rule there established to the facts there involved, i.e., the business of organized professional baseball. As long as the Congress continues to acquiesce we should adhere to—but not extend—the interpretation of the Act made in those cases."

* * *

> "But *Federal Baseball* held the business of baseball outside the scope of the Act. No other business claiming the coverage of those cases has such an adjudication. We, therefore, conclude that the orderly way to eliminate error or discrimination, if any there be, is by legislation and not by court decision."

There is not one word in the *Radovich* decision which indicates an intention of the Supreme Court to overrule the applicability of the *Toolson* decision to baseball. In both *Toolson* and *Radovich,* the Supreme Court clearly leaves it to Congress to make any change in baseball's status under the antitrust laws. In that connection, it may be noted that numerous bills, which would either affirmatively exempt or affirmatively subject all or most aspects of baseball and other organized team sports from or to the antitrust laws, have been introduced into the Eighty-Fifth and Eighty-Sixth Congresses, but none of them has been enacted. (See Eighty-Fifth Congress: H.R. 5307, H.R. 5319, H.R. 5383, H.R. 6876, H.R. 10378, H.R. 10918, S. 4070; Eighty-Sixth Congress: H.R. 2370, H.R. 8658, S. 616, S. 886, S. 2545, S. 3483.)

This Court has made it very clear that (1) it will not undertake to overrule applicable Supreme Court decisions (*Sauer v. United States,* 241 F. 2d 640, 652 (9th Cir. 1957)) and (2) it will sustain decisions of the District Courts which follow applicable decisions of this Court (*California State Board of*

Equalization v. Goggin, 245 F. 2d 44, 45 (9th Cir. 1957)).

Toolson is the controlling law of this case and, accordingly, the decision of the District Court granting the motion to dismiss on the authority of *Toolson* should be affirmed.

Respectfully submitted,

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APPENDIX

All allegations of the Amended and Supplemental Complaint which pertain to the subject matter of the action and the statement of the Portland Club's claim also pertain to subjects or claims which were presented to the United States Supreme Court in one or more of the complaints in the *Toolson, Corbett* and *Kowalski* cases. It is fair to say that the Amended and Supplemental Complaint deals with the following general subjects or claims.

1. The Major League clubs are engaged in interstate trade and commerce through various specified activities such as interstate travel and sale of broadcasting rights and advertising on a national scale.
2. A conclusory allegation that the defendants are engaged in a combination and conspiracy to restrain and monopolize the interstate business of baseball.
3. Certain basic documents of baseball evidence and implement this conspiracy.
4. The defendants control and monopolize the supply of baseball players.
5. The defendants dominate and control the Minor League clubs through ownership of or working agreements with Minor League clubs.
6. The defendants determine the circuits of Major League baseball and seek to deprive Minor League clubs of advancement.

7. The sale of broadcasting and telecasting rights by Major League clubs is illegal, and violates Rule 1-A of Major-Minor League rules.

The following extracts from the complaints in *Toolson, Corbett* and *Kowalski* demonstrate that the claims presented by the Portland Amended and Supplemental Complaint were heretofore presented to the Supreme Court.*

1. Interstate trade or commerce—interstate activities of Major League clubs.

Portland, pars. 2 [R. 4]; 3 [R. 4-7]; 12 [R. 12-15]; 13 [R. 15]; 14 [R. 15-16]; 15 [R. 16]; 16 [R. 16-28].

Toolson, 1st cause, par. IX:

> "* * * that the various teams and leagues and the Defendants herein enter into contracts, for large payments of money, with radio broadcasting and television companies, by which the various clubs cooperate with the radio broadcasting and television companies, in producing the baseball games and transmitting them by narration and as a television picture to the outside public in the various states of the United States."

Corbett, par. XVII:

> All National and American League clubs travel from state to state in the completion of their schedules and transport or cause to be transported at their own expense equipment to play the games.

*The paragraph reference to the Portland Amended and Supplemental Complaint is followed by a bracketed reference to the page of the transcript of the Record where such paragraph is printed.

Par. XIX:

"* * * that in completing the schedule for each season, state lines are systematically crossed; that radio broadcasters announce 'play by play' descriptions of the game (fol. 5) over interstate networks; that television carries the sights and the sounds of the scheduled games across state boundaries; that the seasonal rights to make these broadcasts and telecasts are sold by the clubs of the Major Leagues for large sums."

Par. XX:

"That radio and television, the newspaper publicity and the other avenues and channels of communication used, attendant upon, necessary for and related to the playing of Major League Baseball, and the purchase by the clubs and Leagues for this purpose of essential equipment and the transportation across state lines of essential equipment and of the requisite personnel by the clubs and Leagues for the fulfillment of their respective schedules, cause those administering and playing the game to be engaged in interstate commerce and to derive a substantial portion of their income from such source."

Par. XXI:

Broadcasting and television rights of the "Dream Game" played annually in July between selected members of each League yield larger amounts of income for the broadcasting and television rights than is derived from fees for admissions.

Par. XXII:

"* * * that the sale of the broadcasting and telecasting rights yields to Organized Baseball from the 'World Series' a substantial portion of its income through these sources of interstate commerce; and that the sale of broadcasting and television rights for the 1950 World Series produced a larger revenue than was received for the total fees paid by members of the public for admission to the two ball parks wherein the games of such World Series were played."

Par. XXVIII:

"That further sources of interstate income are derived by the clubs of the Major Leagues from the authority exercised by them in accordance with the provisions of the uniform or standard contracts, under which the players are employed, to 'trade' such players to another club through the assignment by the employing 'farm club' directly or as the agent or intermediary for its 'parent' Major League club, of the players' contracts to such other club as assignee."

Kowalski, par. 30:

"Radio and television, the newspaper publicity and the other avenues and channels of communication used, attendant upon, necessary for and related to the playing of Major League Baseball and to the training and preparation for said playing of the season's schedules, which preparation includes extensive interstate late winter and early spring training schedules of pre-season games; the purchase by the clubs and

leagues of essential equipment and its transport and that of the requisite personnel by the clubs and leagues for the training and preparation for, and in the fulfillment of, their schedules and of their respective contracts with sponsors and radio and television companies and others for the broadcasting and re-broadcasting and telecasting, in whole or in part, of the scheduled, pre-season and post-seasons games, cause those administering and playing the games of Organized Baseball to be engaged in interstate commerce by the derivation of a substantial portion of their income from such source."

2. Major League clubs are in a combination or conspiracy to restrain and monopolize the interstate business of baseball.

Portland, pars. 1 [R. 3-4]; 2 [R. 4]; 5 [R. 8-9]; 16 [R. 16]; 16(k) [R. 25]; 16(m) [R. 26-28]; 17 [R. 29]; 18 [R. 29]; 19 [R. 29]; 20 [R. 29-30]; and 23 [R. 31].

Toolson, 3rd Cause, par. II:

"That the Defendants and each of them, have combined together to monopolize professional baseball in the United States, * * *

Amendment II-A:

"That defendant and those combined with them in said illegal combination have acted in full accordance and fidelity with the terms of the agreement set forth in Paragraph II hereof; that by reason of the combination thereunder the defendants and those combined with them

in said illegal combination control and own all of the players in professional baseball, control all of the teams in professional baseball and control all of the games and exhibitions thereof, including exhibition by radio and television among the several states of the United States; * * *"

Corbett, par. LXXII:

"That defendants have used, and are continuing to use, the 'reserve clause,' the Major League Agreement, the Major-Minor League Agreement and the cognate agreements and rules contrary to the adjudicated principles of equity and common law, and to monopolize or attempt to monopolize trade or commerce among the several states and with foreign nations in violation of section 1, 2 and 3 of the Sherman Anti-Trust Act (15 U.S.C.A., sections 1, 2 and 3) and of section 4 of the Clayton Act (15 U.S.C.A., section 15.)"

Kowalski, par. 34:

"Organized Baseball maintains a monopoly in interstate and foreign commerce over the exhibition of professional baseball games for profit through its exclusive control over the market for professional players."

3. The basic documents of baseball.

Portland, pars. 5 [R. 8-9]; 6 [R. 9]; 8 [R. 11]; 9 [R. 12]; 10 [R. 12]; 11 [R. 12]; 16(a) [R. 17-18] and 16(m) [R. 26-28].

Toolson, 1st cause, par. XI:

> "That the Defendants, and each of them, have entered into or agreed to be bound by a contract in the restraint of Interstate Commerce; that said contract is designated as the Major-Minor League Agreement, dated December 6, 1946 * * *"

Corbett, par. XXVI:

> "That Organized Baseball is governed by the Major League Agreement, Major League Rules, Major-Minor League Agreement, Major-Minor League Rules and the National Association Agreement."

4. The defendants control and monopolize the supply of baseball players.

Portland, pars. 3(a) [R. 4-5]; 12(d) [R. 14]; 16(a) [R. 17-18]; 16(b) [R. 18-19]; 16(c) [R. 19]; 16(d) [R. 19] and sub-pars. (1) [R. 19], (4) [R. 20-21], and (7) [R. 22]; 16(h) [R. 23-24]; 16(m) [R. 26-28]; 16(n) [R. 28] and 23 [R. 31].

Toolson, 1st cause, par. XI:

(Note: Portland's Amended Complaint, par. 16(m) [R. 26-28], sub-pars. (1) through (11) inclusive, is copied verbatim from the following language of *Toolson's* Par. XI:

> "That the Defendants, and each of them, have entered into or agreed to be bound by a contract in the restraint of Interstate Commerce; that said contract is designated as the Major-Minor League Agreement, dated December 6, 1946 and provides in effect that:

1. All players' contracts in the Major Leagues shall be of one form and that all players' contracts in the Minor Leagues shall be of one form.

2. That all players' contracts in any league must provide that the Club or any assignee thereof shall have option to renew the player's contract each year and that the player shall not play for any other club but the club with which he has a contract or the assignee thereof.

3. That each club shall, on or before a certain date each year, designate a reserve list of active and eligible players which it desires to reserve for the ensuing year. That no player on such a reserve list may thereafter be eligible to play for any other club until his contract has been assigned or until he has been released.

4. That the player shall be bound by any assignment of his contract by the club, and that his remuneration shall be the same as that usually paid by the assignee club to other players of like ability.

5. That there shall be no negotiations between a player and any other club from the one which he is under contract or reservation respecting employment either present or prospective unless the Club with which the player is connected shall have in writing expressly authorized such negotiations prior to their commencement.

6. That in the case of Major League players, the Commissioner of Baseball and in the case of Minor League players, the President of the National Association, may determine that the best

interests of the game require a player to be declared ineligible and, after such declaration, no club shall be permitted to employ him unless he shall have been reinstated from the ineligible list.

7. That an ineligible player whose name is omitted from a reserve list shall not thereby be rendered eligible for service unless and until he has applied for and been granted reinstatement.

8. That any player who violates his contract or reservation, or who participates in a game with or against a club containing or controlled by ineligible players or a player under indictment for conduct detrimental to the good repute of professional baseball, shall be considered an ineligible player and placed on the ineligible list.

9. That an ineligible player must be reinstated before he may be released from his contract.

10. That clubs shall not tender contracts to ineligible players until they are reinstated.

11. That no club may release unconditionally an ineligible player unless such player is first reinstated from the ineligible list to the active list."

Amendment II-A, 3rd cause:

"That defendant and those combined with them in said illegal combination have acted in full accordance and fidelity with the terms of the agreement set forth in Paragraph II hereof;

that by reason of the combination thereunder the defendants and those combined with them in said illegal combination control and own all of the players in professional baseball, control all of the teams in professional baseball and control all of the games and exhibitions thereof, including exhibition by radio and television among the several states of the United States. * * *"

Corbett, par. LXXI, 1st cause:

"That the right of reservation has created a monopoly exercised by the Major League club owners; that this monopoly rests upon the grant of franchises to the clubs of The National League upon the basis of the distribution of population in 1890; and for The American League of the distribution of population in 1900; that each circuit requires the unanimous consent of its club owners for a change; that the Pacific Coast is deprived by these private agreements of Major League status; that Detroit with the intervening growth of the motor vehicle industry should have a second Major League Club; that the existence of the monopoly over Major League Baseball has its source in the 'reserve clause;' that the effect this monopoly works against the public interest * * *"

Kowalski, par. 34:

"Organized Baseball maintains a monopoly in interstate and foreign commerce over the exhibition of professional baseball games for profit through its exclusive control over the market for professional players."

5. The defendants dominate and control the Minor League clubs through ownership of or working agreements with Minor League clubs and through subsidies.

Portland, pars. 3(c) [R. 5-6]; 3(d) [R. 6]; 3(f) [R. 7]; 16(a) [R. 17-18]; 16(d)(3) [R. 20]; 16(c) [R. 19]; 16(g) [R. 23]; 16(h) [R. 23-24]; 16(i) [R. 24] and 23 [R. 31].

Corbett, par. XXVI:

> "That Organized Baseball is governed by the Major League Agreement, Major League Rules, Major-Minor League Agreement, Major-Minor League Rules and the National Association Agreement."

Par. XXVII:

> "That these various agreements permit the clubs in the Major Leagues to own or control, or to have their own agreements with, Minor League clubs for the training and development of players upon such 'farm clubs'; and that every Major League club owns one or more of these 'Farm Clubs.'"

Kowalski, par. 79:

> "Article VI, section 4 of The National Agreement prohibited farming by Major League Clubs; that is, the ownership by them of minor league clubs; * * *"

Par. 146:

> "Defendants have permitted the 'Farm System' to operate as a monopoly within a monopo-

ly to the unjust enrichment of defendant Brooklyn National League Baseball Club from the employment of plaintiff for three years and upward under the otherwise unlawful Minor League standard contract of Organized Baseball."

6. The defendants determine the circuits of Major League baseball and seek to deprive Minor League clubs of advancement.

Portland, pars. 16(d) [R. 19] and sub-pars. (5) [R. 21], (6) [R. 21-22] and (8) [R. 22-23]; 16(f) [R. 23]; 16(n) [R. 28]; and 20 [R. 29-30].

Toolson, 3rd cause, sub-pars. 2 and 6 of par. II:

"2. That certain designated cities only shall constitute the circuits of the Defendants, National League of Professional Baseball Clubs and American League of Professional Baseball Clubs; that these circuits thus established shall remain unchanged either by withdrawal from a city, or inclusion of another city or by consolidation of clubs within a city, unless in any case the changes approved by the majority of the clubs in each league, except that the circuit of either Major Leagues shall not be changed except by the unanimous consent of the clubs constituting said league."

* * *

"6. That the existing circuits in the Minor League shall not be so changed as to include any city in the Major League circuit or any place within five miles thereof without the written consent of the league concerned."

Corbett, par. LXXI:

> "That the right of reservation has created a monopoly exercised by the Major League club owners; that this monopoly rests upon the grant of franchises to the clubs of The National League upon the basis of the distribution of population in 1890; and for The American League of the distribution of population in 1900; that each circuit requires the unanimous consent of its club owners for a change; that the Pacific Coast is deprived by these private agreements of Major League status; that Detroit with the intervening growth of the motor vehicle industry should have a second Major League club; that the existence of the monopoly over Major League Baseball has its source in the 'reserve clause'; that the effect of this monopoly works against the public interest; * * *"

Kowalski, pars. 23 and 24:

> "23. The circuit of the National League may not be changed without the unanimous consent of the owner of each franchise in said League."
>
> "24. The circuit of the American League may not be changed without the unanimous consent of the owner of each franchise in said League."

7. The sale of broadcasting and telecasting rights by Major League clubs is illegal.

Portland, pars. 16(d)(2) [R. 19-20], (8) [R. 22-23], 16(j) [R. 24-25], 16(k) [R. 25], 21 [R. 30] and 22 [R. 30].

The Portland Amended and Supplemental Complaint alleges that telecasts of Major League games into Minor League territory are "excessive and illegal" (par. 16(d)(2) [R. 19-20]) and that such telecasts and radio broadcasts violate Major-Minor League Rule 1-A (pars. 21 [R. 30], and 22 [R. 30]).* It is not alleged that such telecasts and broadcasts in themselves violate the antitrust laws; and we cannot see how a *failure* of the Major League clubs to agree to prohibit or otherwise restrict telecasts or broadcasts into Minor League territory could be an antitrust violation. In the *Toolson* case, the much stronger claim was made that the Major League clubs combined to restrict broadcasts and telecasts. *Toolson,* 3rd cause, par. II, sub-par. 3:

> "That to protect the Major Leagues and their constituent clubs in the operation of their franchises in the cities comprising the circuits established and to safeguard the rights of such franchises, the following restrictions on the broadcast or telecast of Major League games were adopted:
>
> (a) Each Major League club may broadcast or telecast its games (both home and away from home) from a station located within its 'home territory.'
>
> (b) No Major League club shall consent to or authorize a broadcast or telecast (including re-

*In a recent case involving all the defendants named in the Portland Complaint, it was held that the broadcasting and telecasting of Major League games into Minor League territories does not violate Major-Minor League Rule 1(a). *Portsmouth Baseball Corporation v. Frick et al.,* 171 F. Supp. 897 (S.D. N.Y. 1959); aff'd._____F. 2d_____(2d Cir. 1960).

broadcast or network broadcast) of any of its games to be made from a station outside its 'home territory' and within the 'home territory' of any other baseball club, Major or Minor, without the consent of such other baseball club.

'The words 'home territory' shall mean and include, with respect to any baseball club, the territory included within the circumference of a circle having a radius of (50) miles, with its center at the baseball park of such baseball club.' "

Toolson amendment par. II-A:

"That defendant and those combined with them in said illegal combination have acted in full accordance and fidelity with the terms of the agreement set forth in Paragraph II hereof; * * * that as a result of said combination the defendant baseball clubs and those combined with them refuse to authorize a radio broadcast of such club's games to be made from a radio station located outside the home territory of that club and within the home territory of another club, during the time that such other club is playing a home game, unless such other club has prior thereto consented to the broadcast of said game or of any game of another club in a comparable league, during said time from a station located within its home territory; that as a result of said combination defendant baseball clubs and those combined with them have refused to authorize a telecast of the games of such clubs to be made from a station located outside of home territory within the home territory of

another club, during the time that (a) a home game of such other club is being played or (b) the away-from-home game is being telecast from any television station or stations located within the home territory of such club, unless such other club has prior thereto consented to the telecast of said game or of any game of another club in a comparable league, during said time from a station located within its home territory; that within said combination the words 'home territory' shall mean and include with respect to any baseball club, the territory included within the circumference of a circle having a radius of 50 miles, with the center of the baseball park of such baseball club, that as a result of such combination the defendant and those combined with them have greatly lessened and eliminated all competition in the exhibition of baseball games by broadcasting or televising among the several states; that the place, time, quality of game exhibited, area within which said exhibit is to be sent have been and are strictly controlled by the defendants and by those combined with them in said illegal combination, * * *"

IN THE

United States Court of Appeals

NINTH CIRCUIT

No. 16,823

ESTATE OF WALTER F. RAU, SR., Deceased, Raymond J. Shorb, Administrator With the Will Annexed, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petition for Review of Decision of the Tax Court of the United States

BRIEF FOR PETITIONER

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CITATIONS

IN THE

United States Court of Appeals

NINTH CIRCUIT

No. 16,823

ESTATE OF WALTER F. RAU, SR., Deceased, Raymond J. Shorb, Administrator With the Will Annexed, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petition for Review of Decision of the Tax Court of the United States

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BRIEF FOR PETITIONER

JURISDICTIONAL STATEMENT

On the 17th day of January, 1956, the Commissioner of Internal Revenue mailed to Petitioner on Review a Statutory Notice of Deficiency proposing deficiences in income taxes and the ad valorem penalty for each of the years 1942

through 1947 inclusive. The Petitioner's Decedent was a resident of Bakersfield, Kern County, State of California and filed individual income tax returns with the District Director at Los Angeles, California. On the 20th day of March 1956, a Petition was filed with the Tax Court of the United States seeking a redetermination of the deficiencies proposed for each of the years in question; on the 25th day of September 1959, the Tax Court of the United States entered its decision after hearing the case on its merits at Los Angeles, California.

On the 23rd day of December 1959, and pursuant to Sections 7482 and 7483, Internal Revenue Code, 1954, Petitioner filed a Petition for Review to the United States Court of Appeals for the Ninth Circuit; jurisdiction was vested in the Tax Court of the United States as provided in Section 7442, Internal Revenue Code, 1954. This Court has jurisdiction to review these proceedings by virtue of the provisions contained in Section 7482, Internal Revenue Code, 1954.

STATEMENT OF THE CASE

This is a petition to review the decision of the Tax Court of the United States entered September 25, 1959, ordering and deciding that there are deficiencies in Petitioner's Decedent's income taxes, and additions to the tax, for the years 1942 to 1947 inclusive as set forth below:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b) I.R.C. 1939
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

QUESTIONS INVOLVED

The questions involved, and the manner in which they were raised in this proceeding, may be summarized as follows:

1. Question of the survival of the fraud penalty imposed subsequent to the death of Petitioner's Decedent; although it was not argued on brief by Petitioner, this issue was pleaded generally in the petition filed with the Tax Court of the United States (R. 6, 7, 8). On brief, Petitioner noted this issue but deferred argument thereon for the reason that the decisions of the Tax Court were unfavorable to Petitioner on this issue; accordingly, Petitioner reserves argument on appeal with respect thereto.

2. The question of the proper method of determining the income of Petitioner's Decedent for each of the years under review; this issue was raised during the hearing in conjunction with stipulations filed with the Court below whereby the parties to this proceeding agreed upon the net worth of the Decedent for each of the years 1942 to 1947 inclusive. Specifically, Petitioner urged the adoption of the net worth method for making such determination under the circumstances prevailing herein. The question of accepting oral testimony of two former employees as constituting "specific items" for reconstructing Decedent's income is an integral part of this question. During the hearing, and on brief, Petitioner opposed the acceptance of such oral testimony on the grounds that it did not constitute an acceptable "method" warranting the rejection of the net worth method; this aspect has been assigned as one of the errors on appeal (R. 91).

3. The question of liability of Petitioner's Decedent for the fifty per cent fraud penalty asserted by Respondent on Review, and sustained by the Court below, for each of the years 1942 to 1947 inclusive; involved in this question is the burden of proof imposed upon Respondent under the

provisions of Section 1112, Internal Revenue Code, 1939; incorporated in this question is the issue of whether or not the Respondent has met such burden by "clear and convincing" evidence under all of the facts and circumstances existing herein. Initially, this issue was raised by Petitioner on Review in its petition filed with the Court below under date of March 20, 1956 (R. 6, 7, 8); it has also been raised in the petition for review (R. 90).

4. The question of the correctness of the liability of Petitioner's Decedent for income taxes as determined by the Court below; this question was raised by Petitioner during the hearing and on brief and represents one of the errors assigned on appeal (R. 91).

SPECIFICATION OF ERRORS

1. The Tax Court erred in deciding that the fifty per cent (50%) fraud penalty survived the death of Petitioner's Decedent.

2. The Tax Court erred in deciding that the Petitioner on Review was liable for the fifty per cent fraud penalty, (Section 293(b), I.R.C. 1939) for each of the years involved herein.

3. The Tax Court erred in deciding that the statute of limitations was not a bar to the assessment and collection of taxes for the years 1942 through 1944, inclusive.

4. The Tax Court erred in that its decision is not supported by the evidence and is contrary to law.

5. The Tax Court erred in rejecting the net worth method, and, by substituting therefor, the uncorroborated testimony of two employees in determining the income tax liabilities of the Decedent for each of the years in question.

SUMMARY OF ARGUMENT

1. The fifty per cent (50%) fraud penalty asserted by the Commissioner of Internal Revenue subsequent to the death of Petitioner's Decedent, pursuant to the provisions of Section 293(b), Internal Revenue Code, 1939, should not survive Decedent's death.

2. In the absence of adequate books and records, the net worth method represents the most reliable means for determining taxable income of Petitioner's Decedent for the years 1942 to 1947 inclusive.

3. Uncorroborated oral testimony, of former employees, does not constitute "specific items", or "specific adjustments", within the ordinary meaning of such phrase.

(a) The stipulation between the parties, as to the net worth of Petitioner's Decedent for the years 1942 to 1947 inclusive, precludes an attack on such net worth in the absence of proof of discrepancies or duplications therein; facts stipulated between the parties are judicial admissions and require no substantiation.

4. The amount by which the Court below increased the income of Petitioner's Decedent over that resulting from the net worth method, is not, in fact, income taxable to Petitioner's Decedent.

5. The evidence presented to the Court below is legally and factually incapable of supporting the allegation of fraud.

(a) in its opinion, the Court below conceded that the testimony of Respondent's witnesses contained minor discrepancies; without comment, the materiality thereof was disposed of by the Court by stating that no useful purpose would be served in reviewing the evidence; thus, a mixed question of law and fact is raised on appeal.

ARGUMENT

PART I. SURVIVAL OF FRAUD PENALTY

It is well established, of course, that, at common law, death abates actions to recover for a wrong-doing. In the absence of specific statutory authority to the contrary, such principle should obtain; applying this basic concept to the question involving the survival of the civil fraud penalty in income tax matters, it is necessary to consider the language of Section 293(b), Internal Revenue Code, 1939; Section 293, I.R.C. 1939, is identified as "Additions to Tax in Case of Deficiency"; Section 293(b) thereof provides as follows: "If any part of any deficiency is due to fraud with intent to evade tax, then fifty per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty per centum addition to the tax provided in Section 3612(d)(2)." The language of that section does not, by implication or otherwise, specifically authorize the collection of any addition due to fraud when such deficiency is not determined until subsequent to the taxpayers' death; lacking such express authorization, the construction of Section 293(b), I.R.C., 1939, should, under recognized principles relating to construction of tax statutes, be construed in favor of the taxpayer.

Notwithstanding the fact that the Legislature employed the words "addition to the tax", it is equally clear that such additions were to be assessed and collected in the event of fraud; fraud itself connotes evil intent and wrong-doing and this, coupled with the amount of such addition, makes it more apparent that such "addition" was intended as a penalty for such wrong-doing. The mere use of such language does not alter the very nature of that which is assessed, collected or paid; to ignore the substantive aspects of this matter is to indulge in sophistry at the expense of logic and reason.

Although this question has been presented to the Tax Court in numerous cases, over a period of many years, it was not until the decision of the Tax Court in *Estate of Louis L. Briden, Deceased,* 11 T.C. 1095, that this question was resolved against the taxpayer. Prior to that time the decisions of the Tax Court, District Courts and Courts of Appeal uniformly held that fraud abated upon the death of the taxpayer. *Thome* v. *Lynch,* United States District Court, Minn., decided February 17, 1921; *U. S.* v. *Theurer, et al,* 215 Fed. 964, C. C. A. 5th (1914); *Wickham* v. *Commissioner of Internal Revenue,* 65 Fed. 2d. 527, 12 AFTR 820, C. C. A. 8th (1933); *National City Bank of New York, Executors* v. *Commissioner of Internal Revenue,* 35 B. T. A. 975 (1937).

In *Estate of Louis L. Briden, supra,* the Tax Court adopted the decision of the Supreme Court of the United States in *Helvering* v. *Mitchell,* 303 U. S. 391, in concluding that the fraud penalty survived the death of the taxpayer; it is significant to note that the question of the survival of the fraud penalty was never mentioned by the Supreme Court in *Helvering* v. *Mitchell, supra;* in fact, the Supreme Court confined its opinion to the distinction between civil and criminal sanctions; the word "sanction" is used repeatedly and, as defined in a desk dictionary in everyday use, a "sanction" is a penalty or punishment. In *Helvering* v. *Mitchell, supra,* the Petitioner contended that an acquittal for criminal tax evasion precluded the assertion of the fifty per cent civil fraud penalty in civil proceedings before the Tax Court of the United States; speaking for the Supreme Court of the United States, Justice Brandeis noted that the Revenue Act of 1928 provided for two separate and distinct provisions imposing sanctions, namely Section 145(b) and Section 293(b) of the Revenue Act; when this question was presented to the Circuit Court of Appeals for the Second Circuit, Justice Learned Hand held that the decision of the Supreme Court in *Coffey* v. *U. S.,* 116 U. S.

436, precluded the assessment of the fifty per cent penalty after an acquittal in criminal proceedings. Not only did the Tax Court, in *Estate of Louis L. Briden, supra,* adopt the decision in *Helvering* v. *Mitchell, supra,* in reaching its conclusion that the fraud penalty did not abate upon the death of the decedent, it went further; without discussing basic concepts, it found that the fifty per cent addition to the tax was not, in fact, a penalty and seized upon the word "addition" in so doing; a penalty involves the idea of punishment. *U. S.* v. *Reisinger,* 128 U. S. 398; *Huntington* v. *Attrill,* 146 U. S. 657; the character of the penalty is not changed by the mode in which it is inflicted, whether by suit or by criminal prosecution. *U. S.* v. *Chouteau,* 102 *U. S.* 603, 611.

When the question of the survival of the fraud penalty was presented again to the Circuit Court of Appeals for the Second Circuit, it affirmed the decision of the Tax Court on that issue. *Scadron's Estate,* 212 Fed. 2d 188, T. C. Memo Decision, 1953; the Second Circuit adopted the opinion of the Supreme Court in *Helvering* v. *Mitchell, supra,* as did the Tax Court in *Estate of Louis L. Briden, supra;* in so doing, however, the Second Circuit observed that if the question had been res integra, it might have reached a different conclusion; reference was made to the construction placed upon Section 293(b), I.R.C. 1939, by the Supreme Court in the Mitchell case in which it was said that the language of that section was not to be considered as penal in any sense; inasmuch as the Supreme Court was distinguishing between the character of Section 145(b) and that of Section 293(b) with respect to the degree of proof required, and not as to the survival of the penalty, the question, in fact, was res integra and the Circuit Court of Appeals for the Second Circuit overlooked an opportunity to meet this issue directly.

In summary, the present status on the question of the survival of the fifty per cent penalty leaves something to be

desired in the way of clarity of thought; until Congress of the United States enacts specific legislation providing for the survival of this penalty, it should abate upon the death of the taxpayer. This position is supported when consideration is given to other causes of action involving civil actions for damages instituted by or on behalf of the United States; in this regard, reference is made to Title 28, Section 2404, U. S. Code, relating to death of Defendant in damage action; that section provides as follows:

> "A civil action for damages commenced by or on behalf of the United States or in which it is interested shall not abate on the death of a defendant but shall survive and be enforceable against his estate as well as against surviving defendants." June 25, 1948.

Thus, it is quite obvious that Congress found it necessary to enact specific legislation in order to prevent the application of common law principles in civil actions for *damages.*

PART II. NET WORTH METHOD MOST RELIABLE FOR DETERMINING TAXABLE INCOME

The information reflected in the Decedent's net worth for the years 1942 through 1947 inclusive was obtained from various third party sources and was subjected to critical examination by Respondent prior to the stipulation thereof (Appendix pages 41-42); the absence of documentary evidence revealing errors and duplications in the net worth statement deserves more than token consideration; this fact, alone, serves to impugn and contradict the testimony of Respondent's witnesses. It might well be argued that Respondent should have substantiated the testimony of its own witnesses in increasing Decedent's income in excess of that resulting from the net worth method rather than representing to the Court below that such testimony was employed for the purposes of substantiating Decedent's net worth (R. 226).

In support of its rejection of the net worth method in determining Decedent's taxable income, the Court below cited the case of *Emilie Furnish Funk* v. *Commissioner of Internal Revenue,* 29 T. C. 279, 299-293; Aff'd. 262 Fed. 2d. 727, C. A. 9; a review of that decision reveals a marked dissimilarity in the facts in that case with those involved in the instant proceeding. In *Funk* v. *Commissioner, supra,* the Petitioner engaged an auditor to examine the records maintained by the Petitioner, a physician, in the course of his medical practice; these records, patient cards, reflected the fees received by the Petitioner and constituted documentary evidence of his income; these records, therefore, constituted specific items of income as prepared by the Petitioner himself and the necessity of employing a different method of determining his income was nonexistent. Petitioner has no quarrel with the decision in the Funk case but opposes the application thereof to the facts in the case under review. In the Funk case, there were omissions and duplications in the net worth statement and there was no showing that such net worth was a part of the stipulations between the parties; the actual receipt of the monies taxed to the Petitioner in the Funk case was established by his own records and did not rest upon oral testimony for substantiation.

In *Funk* v. *Commissioner, supra,* the "specific items" were substantiated by actual documentary proof, whereas, the so-called "specific items" (oral testimony) in the present case lacked comparable substantiation; to illustrate, it may be assumed that income was actually withheld, as claimed by Respondent, and yet there is no evidence of any kind establishing that these receipts were not deposited in Decedent's several bank accounts; in other words, the withholding of receipts, standing alone, does not prove that such receipts were not deposited in the Decedent's bank accounts. The question of cash on hand is not involved in the present case and we are not here confronted with any self-serving declaration relative to the net worth statement

as was the situation in the Funk case; not one dollar of income, in excess of Decedent's net worth, has been traced to the possession of Decedent other than the funds on deposit in his bank accounts. The Decedent did not use conduits or agents in reporting his income and the funds attributed to the Decedent in excess of his net worth are singularly related, in amounts, to the funds deposited by his two employees in their personal bank accounts. In the Funk case, the Petitioner was a well educated physician and there was no evidence that he was addicted to the excessive use of alcohol; there was no showing that he entrusted the operation of his profession to employees; there was no evidence in the Funk case indicating that Petitioner's employees conducted private financial transactions in amounts far in excess of their known income. In an effort to account for the income in excess of Decedent's net worth, Petitioner was faced with the onerous task of ferreting out the private financial affairs of Respondent's witnesses. The whereabouts of such enormous funds, over and above Decedent's net worth was unknown; therefore, Petitioner endeavored to discover the location and final disposition of such funds. Although Petitioner succeeded in tracing substantial sums to the personal bank accounts of Respondent's witnesses, it lacked the authority to compel them (Webb and Goldstein) to disclose the contents of their safe deposit boxes; on the other hand, it is a relatively easy task for Respondent to obtain such information and, under the circumstances, it is submitted that Respondent had the duty of removing the "smoke" which the Court below said that Petitioner generated in this regard (R. 256).

It is well to review the findings of the Court below relative to its determination of taxable income; having rejected the net worth, and having accepted the testimony of Webb and Goldstein as "specific items", the total tax liability of Decedent, including the amounts previously paid, for the years 1942 through 1947 inclusive, according to the Tax Court, aggregates the sum of approximately $330,000.00,

exclusive of the fifty per cent penalty; the net increase in Decedent's net worth for this period was $184,000.00 as compared with the sum of $187,000.00 in additional income taxes as determined by the Court below. In addition to accepting the so-called "specific items", of withheld income, the Court below further increased Decedent's income to the extent of alleged overstatement of purchases for the years 1943 to 1946 inclusive as claimed by Respondent in its Amendment to Answer (R. 41, 42); in its reply to Respondent's Amendment to Answer, Petitioner resisted this increase on the grounds that the Statutory Notice of Deficiency already reflected such alleged overstatements and that any further allowance would result in a duplication of income (R. 43, 44, 45); without a hearing on this issue, the Court below accepted Respondent's determination. The findings of the Tax Court as to the amount of the deficiency may be more graphically illustrated in the following tabulation:

Additional Net Income	1942	1943	1944	1945	1946	19
Per Tax Court	29,935.00	83,466.89	62,768.07	31,214.14	11,675.81	12,9
Net Worth Basis	3,907.18	7,524.89	40,204.47	57.395.08	(6,458.50)	(1,7
Net Increase Over Net Worth	26,027.82	75,942.00	22,563.60	(26,180.94)	18,134.31	14,72

Total Additional Income Per Tax Court Findings	$232,03
Total Additional Income Per Net Worth Method	100,81
Total Increase Over Net Worth Per Tax Court Findings	131,21

	1942	1943	1944	1945	1946	19
Tax Liability Per Tax Court	5,901.47	52,913.50	53,725.33	46,292.81	12,303.72	17,21
Taxes Paid	690.09	6,254.03	6,995.32	27,638.93	51,708.95	50,17
Difference	5,211.38	46,659.47	46,730.01	18,653.88	(39,405.23)	(32,95

Total Tax Deficiency Per Tax Court	$188,350.94
Total Taxes Paid	$143,458.99
Total Liability	$331,809.93

By accepting the Tax Court's determination, one is compelled to accept the proposition that Petitioner's Decedent was in possession of approximately $131,000.00 at the end of 1947, a fact which has never been substantiated by any evidence whatsoever.

Viewing this situation realistically, it is not unreasonable to characterize such a result as the product of imagination. Not only is the decision of the Tax Court lacking in realism, its findings are predicated upon surmise and conjecture; specifically, by accepting the testimony of Webb and Goldstein as "specific items", the Court below has, in effect, surmised that the so-called "withheld receipts" were not deposited in any of the Decedent's bank accounts; there is no evidence in the record that such receipts were not so deposited. The Court below made its determination notwithstanding the fact that the balances in Decedent's bank accounts totalled $87,471.89 as of December 31, 1947; included in this figure is the sum of $22,000.00 representing Decedent's cash contribution to a partnership venture by withdrawing funds from his bank account.

In summarizing this aspect of the finding of the Court below, it should be noted that no consideration has been accorded the possibility that the so-called "withheld receipts" might have been used in acquiring assets; the reasonableness of this hypothesis deserves greater weight than the conclusion of the Tax Court that Decedent was in possession of at least $131,000.00 at the end of 1947. It is most significant to observe that, in the final analysis, the testimony of Webb and Goldstein does not conclusively establish that the withheld receipts were not, in fact, deposited in Decedent's bank accounts; nor, indeed, does such testimony preclude the possibility that the withheld receipts were used in the acquisition of assets. The substance of their testimony is that receipts were withheld and neither of these witnesses mentioned or attempted to account for the ultimate disposition of the withheld receipts. It is submitted,

therefore, that the finding of the Court below as to the deficiencies for each of the years in question is clearly erroneous and is not supported by the evidence.

PART III. UNCORROBORATED ORAL TESTIMONY DOES NOT CONSTITUTE "SPECIFIC ITEMS"

Heretofore, unsubstantiated oral testimony has not served as an acceptable basis for determining the income tax liabilities of a taxpayer; nor has it received prior judicial approval in ascertaining deficiencies against an Estate where, under ordinary circumstances, an abundance of caution is essential in safeguarding the rights of a Decedent's Estate. The duty of protecting the revenue should not be exercised in derogation of these rights. Historically, Courts have always scrutinized claims against an Estate with utmost care; claims for additional taxes and penalties should not be regarded as an exception; in representing an Estate, the representatives are obliged to perform their duties without the benefit of any assistance from the Decedent. It is obvious, therefore, that the representatives must conduct the affairs of the Decedent under a handicap with which Respondent is not burdened. Notwithstanding these well recognized principles, the Court below approved and accepted, without exception, Respondent's method in determining the deficiencies in income taxes in the case under review.

Within the ordinary meaning of "specific items", the items themselves must be definite or ascertainable; they must be identifiable as by a record or document and should not, of course, depend upon oral testimony alone. In the instant case, all of Decedent's records were not available and could not, therefore, be offered in evidence. Despite this, however, the Court below has classified such unsubstantiated oral testimony as, "specific items"; the entries appearing in the daily cash sheets purporting to identify withheld receipts do not conclusively prove that the amount

was actually withheld for the reason that these same records also contained additions to receipts which were arbitrarily added to the records reflecting daily cash receipts. Furthermore, the possibility that these entries were made by Webb and Goldstein, for the purpose of concealing a well designed plan of embezzlement should not be disregarded; inasmuch as these employees had complete control over the operations of the Decedent's businesses, it was a relatively simple matter, after the death of the Decedent, for these two individuals to claim that this income was withheld by the Decedent at his instructions and, by so doing, they themselves could disclaim the receipt of such income.

If their testimony is not false, one important question must, of necessity, persist throughout this proceeding, that is, where is the sum of $131,000.00? Neither Respondent's agent nor the Executor or Administrator for Decedent have any knowledge of the whereabouts of this money; in all candor, it is submitted that no such sum ever existed.

By defining the unsubstantiated oral testimony as "specific items", the Court below has actually succumbed to every argument and claim advanced by Respondent and has, at the same time preemptorily disregarded the arguments and claims presented by Petitioner.

One of the principal arguments advanced by Petitioner in opposition to the matter of "specific items" and on which there is no discussion in the opinion of the Court below, involves the stipulation of the net worth; Petitioner argued that this fact precluded an attack on the net worth in the absence of discrepancies or duplications; inasmuch as stipulations constitute judicial admissions, there is no need for substantiation. Prior to its becoming a part of the stipulations, the net worth entailed considerable painstaking work and it was thoroughly examined by Respondent. The fact that this method has had judicial approval on numerous oc-

casions justified the adoption thereof by Petitioner in support of the proposition that the net worth method was the most reliable in the absence of adequate books and records in determining income. Due to Respondent's failure to present documentary corroboration of oral testimony, the determination of Decedent's income should be confined within the bounds of the net worth as presented.

PART IV. THE AMOUNT BY WHICH INCOME WAS INCREASED IN EXCESS OF DECEDENT'S NET WORTH IS NOT, IN FACT, INCOME TO THE DECEDENT

By increasing Decedent's income in excess of that resulting from the net worth method, the Court below could have done so only by characterizing the testimony of Webb and Goldstein as "credible, consistent, powerful and persuasive", coupled with the assumption that the so-called "withheld receipts" were not deposited in Decedent's bank account without actual proof that they were not so deposited. Upon reviewing the testimony of Webb and Goldstein, a serious question is raised as to whether their testimony is credible and consistent. A second serious question is raised when their private financial transactions in large sums are analyzed in relation to the alleged withheld receipts.

In commenting upon this aspect of this proceeding, it is considered advisable to set forth an analysis of the testimony of Respondent's witnesses:

I. WITNESS: ROBERT WEBB

A. Illustrations of Self-Contradictions

(1) In Re: Envelopes in Which Alleged Withholding of Receipts Were Placed

On one occasion, Webb testified that he used three envelopes in which the receipts, allegedly withheld from the French Cafe and the Southern Bar, were kept. One envelope, marked "Cafe", contained receipts of $10.00 per day supposedly withheld from that business. The second enve-

lope, marked "Bar", contained receipts of $25.00 per day allegedly withheld from the receipts of this operation. The third envelope contained the unusual amounts allegedly withheld on Saturdays, Sundays and holidays. R. 349-354 incl. On another occasion, he stated that four different envelopes were used. R. 349.

Note: An examination of the record fails to establish the actual use of four separate envelopes.

This witness stated that W. F. Rau, Sr., *never* touched the envelope containing the $10.00 per day nor the one containing the $25.00 per day. R. 350, 352. Webb never recalled an occasion on which the envelope was empty when he opened it at the end of the month. R. 349. He also said that he never saw Mr. Rau open either the $10.00 or the $25.00 envelope; that he himself took the money out of both of these envelopes. R. 338, 350, 354. At a subsequent time, he stated that there were occasions when there would be no cash left in either the $10.00 or the $25.00 envelope at the end of the month. His testimony verbatim was "I recall it, that would be all taken out". R. 353.

When Webb was questioned as to whether or not he wrote the words, "French Cafe", on the envelope when he put the cash in it, he stated, "Oh yes, yes, I did". R. 195. In response to a question previously asked as to how often he wrote "French Cafe" on the envelope, he replied, "Once". R. 154. On still another occasion, he was asked, "Now, when did you write 'French Cafe' on the envelope?" His answer was, "On the first time I put any money in there". R. 195.

With respect to the receipts that Webb placed in the envelopes, he testified that the receipts of the Southern Bar were brought to him by the bartender in the morning. R. 166. At a later time he testified that the receipts were left in the cash register by the bartender and that he (Webb) took them from the cash register along with the register

tapes. R. 169. Previously, on direct examination, this witness testified that *he* went to the cash register at the bar in the morning to get the receipts, tapes and tickets and that he then waited for Mr. Rau to come down stairs; that if Mr. Rau did not come down that morning, then he, Webb, took the receipts, tickets and tapes upstairs to Mr. Rau; that he put the $25.00 in an envelope. R. 117. The only logical inference to be drawn from this testimony is that the placing of the $25.00 in the envelope must have occurred in the morning. On still another occasion, Webb stated that he put the receipts from the bar and the cafe in an envelope at 4:00 P. M. R. 173.

The testimony of this witness as to the whereabouts of the receipts which he received at 7:00 a. m. from the French Cafe and the Southern Bar, until he placed the money in the envelopes at 4:00 p. m. is very vague and indefinite. Counsel for respondent endeavored to clarify this situation and it was then developed that the cash receipts received by Webb at 7:00 a. m., "laid there" until 4:00 p. m. R. 173-179 incl. When the Court interrogated Webb on this point, he failed to account for the whereabouts of the receipts from 7:00 a. m. until 4:00 p. m. The Court's understanding was that the entire receipts were deposited in the bank the following morning, but Webb's testimony is contra. R. 177-179 incl.

(2) In Re: Daily Cash Sheets of the French Cafe (Exhibits 20 to 24 Inclusive)

Webb had previously testified that the decedent was mentally "sharp" and "alert". R. 149. However, when he was questioned as to his reason for taking the daily sheets of the French Cafe up to Mr. Rau instead of the day books (Exhibits O, P, Q, R, S), reflecting the receipts of the French Cafe *as well as those for the Bar,* he said, "That would not give him a true picture of the receipts; the reason I didn't show him that." Along these same lines, the

following question was asked of Webb, "Wouldn't give him a true picture of the receipts?". Webb then answered, "No. If I showed him $256.07, he wouldn't know what that meant". R. 368.

In analyzing this testimony, it must be remembered that the receipts of the Cafe and the Bar, as recorded in the day books (Exhibits O, P, Q, R, S), were identical to those appearing in the daily sheets of the French Cafe. In fact, the day books were employed by Rose Goldstein for recording the receipts of both operations. R. 422.

When Exhibit 20, the daily sheets of the French Cafe, was exhibited to Webb for the purpose of getting his explanation relative to the additions reflected thereon, he testified that the additions to the daily receipts were made for the purpose of making the deposits "look better". R. 297. According to him, the additions brought the deposits over $300.00, and this, in turn, was the way in which the deposits were made to "look better". Mr. Webb repeated this as his explanation on several occasions. R. 297, 298.

When the daily sheet of the French Cafe for the date of Tuesday, September 21, 1943, was shown to Webb, he explained that the addition of $61.30 to the receipts was done for the purpose of making the deposits in excess of $300.00. The receipts themselves, however, amounted to $354.38, exclusive of the addition of $61.30. The total deposits on that date amounted to $415.68.

A similar explanation was given by this witness when the daily sheet of the French Cafe for Wednesday, September 2, 1943, was shown to him. The receipts on that day amounted to $308.13 without any adjustment in the form of additions to receipts. R. 313.

The daily sheet of the French Cafe for Friday, September 24, 1943, reflected receipts of $306.10 exclusive of any adjustment with respect to additions or deductions. R. 314, 316-317.

The daily sheet of the French Cafe (Exhibit 20) Saturday, September 25, 1943, reflected receipts in the amount of $483.90, less alleged deductions of $110.00, resulting in a net amount to be deposited of $373.90, to which was added the sum of $27.20 resulting in net deposits of $401.10. This amount is far in excess of the $300.00 which Mr. Webb explained as the reason for the additions to the receipts of the French Cafe. R. 316, 317.

The daily sheet of the French Cafe for Monday, September 27, 1943, reflected receipts in the amount of $332.76, from which was subtracted the sum of $10.00, resulting in a total of $322.78, to which was added the sum of $32.15, resulting in a total deposit of $354.93, which exceeds the $300.00 which Mr. Webb stated was necessary in order to make the deposits "look better". R. 317.

On another occasion, Webb testified that Mr. Rau would state that he had too much money in his bank accounts and therefore instructed Webb to make withdrawals and to transfer the funds into another account or to deposit these funds in Mr. Rau's personal account. R. 265. When a check drawn by Webb in the amount of $615.00 on January 4, 1945, part of Exhibit 18, was shown to him, he explained that the purpose of drawing this check was on instructions from Mr. Rau because, Mr. Rau said, he had too much money in his bank. At that time, the bank balance was $20,759.79; Webb explained that the check in the amount of $615.00 was drawn for the purpose of "cutting down the balance a little bit". R. 276. On the one hand, Webb explains that the additions reflected on the daily sheets of the French Cafe were entered for the purpose of making deposits "look better". This, of course, has the effect of *increasing* the bank balances. On the other hand, he has a contrary explanation with respect to the drawing of a check to cash to cut down a bank balance of more than $20,700 by the mere sum of $615.00.

(3) In Re: Issuance of Checks

The record clearly establishes that Webb had the authority to draw checks on the bank accounts of the Southern Hotel and the Southern Bar maintained in the Bank of America and, that he had a like authority to draw checks on the bank account of the French Cafe maintained in the Anglo California Bank. R. 179, 235.

According to him, the expenses at the French Cafe were paid by cash except for an order amounting to $100 to $150 or $200. R. 180. He further stated that everything for the Southern Wine and Liquor Bar was paid for by check. The exceptions included such things as ice, limes, oranges or incidentals. R. 180. When he was questioned as to whether he actually did the buying for the French Cafe, Webb stated that he thought that there was one check on the French Cafe in the amount of $3,500.00 that was made payable to him that he evidently cashed. R. 181.

Subsequently, he stated that he spent very little time in the Cafe. In fact, he said that he didn't have anything to do with the Cafe; and, as to the operation of the Bar, he would "go back and forth" but there were no special hours or duties performed by him at the Bar. The Court's understanding of this witness' testimony, with respect to the operations of the Cafe, was that he had nothing to do with that business apart from "receiving cash." In answer to that statement of the Court, Webb answered, "Yes sir, your Honor". R. 294. At a later time, a total of 596 checks issued by Mr. Webb in connection with the payment of operating expenses of the French Cafe, including payroll, for the years 1944, 1945, and 1946, were shown to him; this, of course, is not just "receiving cash". Previously, he had stated, "I didn't do any buying in the French Cafe". R. 155.

According to his testimony, Webb did the buying for the Southern Bar for a period of one and a half to two years, or during 1945 and 1946, until the bar was closed. R. 154,

155. At this point, 157 checks, representing purchases for the Southern Bar for the calendar year 1944, bearing the signature of Mr. Webb, were exhibited to him. All of these checks were payable to cash. R. 154, 155. It was here, that Mr. Webb stated that there was no buying in the form of cash at the bar. According to him, all purchases were made by check. R. 155. Subsequently, however, he testified that the payouts for the Southern Bar were practically all by check except for ice and incidentals. R. 371. On two separate occasions, Webb stated that, in making the checks out for the expenses at the bar, he drew the checks payable to the *supplier*. R. 371. When the 157 checks drawn on the bank account of the Southern Bar for the calendar year 1944 were shown to Mr. Webb, he admitted that all of them were payable to *cash*. R. 372. As to this, Webb stated that he could explain the purpose for which the checks were drawn if he could look at the check stubs. R. 372. When the check stubs (Exhibit 26) were shown to him, however, the only notation appearing thereon was that of "supplies". R. 373, 374.

Webb had consistently testified that receipts were being withheld from the French Cafe and the Southern Bar each day in the week in the respective amounts of $10.00 and $25.00 and that larger amounts were withheld from these operations on Saturdays, Sundays and holidays. When he was called upon for an explanation as to the purpose of drawing checks to cash in view of the fact that he was withholding receipts in the amounts already testified to, his explanations were very vague and indefinite. R. 270-276.

Webb had previously testified that Mr. Rau moved from the Southern Hotel in the latter part of 1945 and that he thereafter lived in his home on Brighton Way. He also stated that Mr. Rau would come back to the hotel, nearly every day, except when Mr. Rau was away on a vacation. When he was interrogated with respect to whether or not he first obtained permission from Mr. Rau every time he

drew a check on the business bank accounts, he stated, "Absolutely". On another occasion, he testified that there never was any exception to this practice. R. 266. He further stated, that Mr. Rau was "right there", otherwise he (Webb) could not make the check out. R. 264. It is apparent, therefore, on those occasions when Mr. Rau did come to the hotel, or when he was away on his vacation, that he could not give Webb permission to draw checks, nor could Mr. Rau be "right there". On one occasion, Webb denied that he was a partner in the operation of the French Cafe at the time certain checks were drawn on the bank account of that enterprise. R. 334. Subsequently, however, he admitted that his signature appeared as drawer on check No. 1290 dated June 19, 1947, at which time he was a partner in the operation of the French Cafe with Mr. W. F. Rau, Sr. and Mr. Phil Bender. R. 335.

(4) In Re: Physical Condition of Mr. W. F. Rau, Sr.

Webb testified that Mr. Rau's physical condition was good up until the last two years, namely 1946 and 1947. R. 149, 150. He also stated, however, that Mr. Rau had a lot of trouble with his legs and that he used a cane. R. 151. On another occasion, he stated that Mr. Rau "got around very fast in the hotel; he could walk as good as anybody". R. 183. At still a later time, this witness stated that "he (Rau) wasn't a well man". R. 184. At another time, Webb said of Mr. Rau, "but he didn't like to go out on the street; when he went outside he usually got in the car and he would drive". R. 183-184.

(6) In Re: Other Instances of Self-Contradictions

On direct examination (Exhibit N), the day book for 1944 was shown to Mr. Webb and he answered that the entry under date of Sunday, February 6, 1938, was in his handwriting. R. 107-108.

Webb testified that the receipts from the Bar were withheld at the rate of $25.00 per day and that on Saturdays,

Sundays and holidays, they were understated from $100.00 to $200.00 each day. This testimony was repeated by Webb on several occasions. R. 135, 136.

On direct examination, he stated that he could not swear that $100.00 on Saturdays, Sundays and holidays was withheld from the receipts of the Southern Bar in 1942. When the Court interrogated Webb along these lines, he stated that the practice of taking $100.00 a day for Saturdays, Sundays and holidays from the receipts of the Southern Bar began a few months after Pearl Harbor, or December 7, 1941. R. 137. Further interrogation in this connection resulted in testimony that the practice of taking more than $25.00 per day from the Southern Bar commenced in the latter part of 1942. R. 137-138. When Webb was confronted with the inconsistency in his testimony, he attempted to explain that he thought the questions related to the operations of the French Cafe, which, it should be remembered, involved the alleged taking at the rate of $10.00 per day from receipts and had nothing to do with the taking of $25.00 per day from that operation. R. 137, 138. Subsequently, this witness stated that the practice of taking $25.00 a day from the receipts of the Southern Bar began in the first part of 1942. R. 138, 139.

When Webb was questioned as to the number of hours per day that Rose Goldstein devoted to keeping the books for the decedent, he stated that there wasn't any set time. He further stated that she might work all evening, "maybe half a night, sometimes, all depended on how busy we were". When he was asked how he knew that Rose Goldstein worked half the night, he replied as follows, "Well, I was in there plenty of times during the night and seen her in there." When he was interrogated as to his coming to the hotel at night time, after working from 7 A. M. until 7 P. M., he stated, "I might come in the bar and have a drink, or see some friends and do most anything". When he was asked if he would stay later than 12 o'clock at night

at the bar, he replied by saying, "Sure". R. 160. When he was asked whether or not, on the occasions he returned to the bar at night time, he bought whisky for his friends, he stated, "No, very rarely I would buy any drinks. I thought I was entitled to drink on the house". When he was further asked as to whether or not he meant the drinks were "on Mr. Rau", he replied, "That is right". He further stated, "I had many drinks." A little later on, Webb stated, "And as far as going up there (at the bar), I didn't go up there too often, because I worked till 7 o'clock, and at night, and I couldn't stand it; when you work from seven to seven, you're not going to do too much running around". R. 208, 209. When it served the purpose of this witness, he testified, on one occasion, that he was in the hotel and bar "plenty of times". This was his testimony in order to support the work of Rose Goldstein with respect to her duties at the hotel when he was off duty as well as the work which she performed in keeping the books. However, when it developes that he is taking advantage of Mr. Rau in the evenings, not only from the standpoint of taking his meals at the hotel but also drinking whisky at the bar, he then states that as far as going up to the hotel or the bar was concerned he didn't go up there very often.

When Webb was interrogated concerning the proceeds of a check dated May 2, 1947 in the amount of $1,200.00 drawn by him on the Anglo California National Bank, Bakersfield, California, and endorsed by him as "W. F. Rau, Sr.", he stated that such proceeds were deposited by him in his personal bank account at the Bank of America on May 27, 1947. R. 243. When, however, the Court directed Webb's attention to the fact that the deposit of $1,200.00 in his personal bank account was twenty-five days subsequent to the date on which the check was drawn, he then stated, "Well, that is a different deal then". R. 245.

On one occasion, Webb testified that the cancelled checks and the bank statements went to Rose Goldstein when they

were returned from the bank. R. 249. He also stated that the cancelled checks and bank statements were kept in the front desk drawer at the hotel. R. 250. The only fair interpretation of this testimony, is that the cancelled checks and the bank statements, if they went to Rose Goldstein, were presumably kept in her desk at the lobby. If that is true, Mr. Rau did not see the bank statements or the cancelled checks for the simple reason that he never went to Rose Goldstein's desk, as stated by Webb on a previous occasion.

It is well to review the testimony of Mr. Webb relative to a transaction involving the issuance of a check in the amount of $3,500.00. This particular check according to Webb, related to the purchase of a home by Mr. W. F. Rau, Sr., located at 318 F Street, Bakersfield, California, in 1942. This check was drawn by Robert Webb on the bank account of the French Cafe and was payable to cash, or to Robert Webb. Webb places the date of this transaction in 1942. He did so on two occasions; he was able to substantiate this date because, as he stated, "It finally dawned on me, because I lived in the house for five years, and it was 1942 before the real estate prices went up. That is, I know he got this, he bought the house right then, and Mr. Mongerson wanted to get out of town, as fast as he could." R. 181-183 incl. The stipulations of fact reflect that the house, referred to by Webb, located at 318 F Street, had been purchased at least by 1941. Webb stated that he was unable to give an explanation for this transaction to the Revenue Agents when he was interrogated by them in 1949 but that now, in 1958, he was able to recall it. R. 181.

According to Webb, the French Cafe opened for business sometimes at 7 A. M. and, at other times, at 10 or 11 A. M. R. 166. Presumably, he makes this statement in view of the fact that he had already testified that his hours were from 10 A. M. to 5 P. M. after 1945 or 1946. He had previously stated that the steward of the French Cafe gave him the

cash receipts of that business at 7 A. M. each morning. This testimony had been consistently given by Webb as demonstrated by the record. R. 164-179 incl. Even a cursory examination of Webb's testimony in this connection, leads to the conclusion that he was endeavoring, throughout his testimony, to protect himself at all times. Specifically, Webb would have the Court believe that he received the receipts of the French Cafe directly from the steward and that only that which the steward gave to him was what he had in his possession. In order to accomplish this, it was necessary for Webb to state that the French Cafe did not open for business until 10 or 11 o'clock in the morning after he changed his starting hours from 7 A. M. to 10 or 11 o'clock in the morning.

B. Contradictions by Other Witnesses

(1) By Rose Goldstein

Rose Goldstein testified that both W. F. Rau, Sr., and *Mr. Webb* instructed her to make the entries in the cash journal. R. 435. According to Webb, however, he knew nothing about the books, and as a matter of fact, he stated, "Didn't look at them". "I did not understand them." R. 260.

This witness also testified that there were no cash payouts at the Southern Bar. R. 444. In this connection, Webb stated that there were cash payouts for such things as limes, ice and incidentals. R. 371.

(2) By Mrs. Betty Dorsey

Webb had testified that he took the daily sheets of the French Cafe up to Mr. Rau along with the cash register tapes as well as the tickets, and that he left the cash register tapes in Mr. Rau's room. R. 369-370. Mrs. Betty Dorsey, however, testified that she never saw Mr. Webb bring any books or records or cash register tapes up to Mr. Rau while she was employed as his nurse from the latter part of 1945

up until the date of Mr. Rau's death in January, 1953. R. 543, 553-557.

Webb had testified that Mr. Rau was mentally "sharp". R. 149. According to Mrs. Dorsey, Mr. Rau was not mentally alert at all times, nor was he quick and alert in his responses to questions. R. 543-544. In fact, Mr. Rau was subject to spells of weeping and crying when she first began her employment with him. R. 544.

Webb had testified that Mr. Rau usually carried pretty large sums of money in his pockets at all times. R. 197. Mrs. Dorsey refutes this testimony when she states that on the occasions that she emptied Mr. Rau's pockets, before sending his suits to the cleaners, she never saw any large sums of cash. R. 545.

Webb stated that he took the cash receipts together with cash register tapes and tickets up to Mr. Rau in his room when Mr. Rau did not come downstairs. R. 117. He also stated that he left the cash register tapes in Mr. Rau's room. R. 370. Mrs. Dorsey testified that there were no records or cash register tapes in Mr. Rau's room while she was employed as his nurse. R. 543.

On several occasions, Webb testified that Mr. Rau was "right there" every time he drew a check on any business operation. He reaffirmed this by repeating that Mr. Rau was always there and there were never any exceptions. According to Mrs. Dorsey, Mr. Rau was confined to his bed for a period of at least three weeks in the latter part of 1945 and that at no time did anyone ever bring any books and records of any kind up to Mr. Rau, nor did she see him make any entries in any of these books and records, which, of course, must be interpreted to include the signing of checks by Webb. R. 542-544 incl.

Webb had testified that up until 1946 and 1947, Mr. Rau's physical condition was "good", but Mrs. Dorsey testified

that Mr. Rau was unable to dress himself when she began her employment with him in the latter part of 1945. R. 545.

Webb testified that he was at the bank at 10 o'clock every morning, making deposits and doing other banking transactions, including the cashing of checks. According to Mrs. Dorsey, she never took Mr. Rau to the hotel, after they had moved to his home until around 11 o'clock in the morning. This, of course, can only mean that many banking transactions, involving the cashing of checks and the depositing of cash, occurred prior to the time that Mr. Rau arrived at the hotel. R. 563. Furthermore, Mrs. Dorsey stated that, although they went to the hotel quite often, they did not go every day. R. 563.

According to Webb, Mr. Rau knew about everything, including every transaction, in connection with the operation of the businesses. Mrs. Dorsey, however, testified that Mr. Rau did not seem to have any interest in his businesses for the reason that he spent most of his time in his room and, after moving from the hotel, spent most of his time at home. R. 543, 547, 553-554, 555-556, 558, 559, 562.

II. WITNESS: ROSE GOLDSTEIN

A. Illustrations in Self-Contradictions

(1) In Re: Bookkeeping Duties

Rose Goldstein had testified that she devoted very little of her time to the keeping of the books and records for the decedent because, as she had stated, she spent most of her time in her other businesses. R. 504. She elaborated somewhat on this and stated that, "the only book work I did, was post the checks, which didn't take me long". R. 504. The record establishes that this witness made entries on the daily sheets of the French Cafe when Mr. Webb was either absent or was not there on Sunday. She recorded the receipts of this operation. R. 422, 423-424. This witness also maintained the ledger and made the entries therein. Miss Goldstein also recorded cash purchases. R. 427. In addi-

tion to these, she made out the deposit tickets when Mr. Webb was away and then saved them until he returned. R. 491. She kept the books and records for the decedent from 1936 up until the termination dates of the various businesses as indicated in the record. R. 419. It is also an undisputed fact that she worked at least two hours each day while Webb took a nap from 12 o'clock noon until 2 P. M.; and that she relieved Webb for two hours on Sunday and that she worked all day on the following Sunday; that she worked on Saturdays, Sundays and holidays, performing, on those days, the duties customarily performed by Webb. Such work, of course, involved the handling of cash receipts of the Southern Hotel, French Cafe and the Southern Bar. In registering guests at the hotel, she must have made the necessary entries in the records of that business. Entire record.

(2) In Re: Cash Receipts of the French Cafe and the Southern Bar

On one occasion this witness testified that she gave the cash receipts of the French Cafe and the Southern Bar to Mr. Rau during Webb's absence. R. 481. She had previously testified that she placed the cash receipts from these operations in an envelope until Mr. Webb returned on Monday, at which time she gave the envelope to him. R. 446-447. Subsequently, Goldstein stated that the receipts of the French Cafe were placed in a cigar box and that she removed them for the purpose of counting the money for Mr. Rau; that she had left the money on the counter for Mr. Rau, but refused to state whether or not she personally gave the money to him. R. 488, 489.

B. Contradictions by Other Witnesses

(1) By Walter Slater

Rose Goldstein stated that she was unable to recall an examination of Mr. Rau's income tax returns for the taxable years 1942, 1943 and 1944. R. 492. She was likewise unable to recall Mr. Walter Slater, the Revenue Agent who

made the examination. R. 491. In view of Goldstein's inability to recall that such an examination was conducted or the Agent who performed it, the fact that Revenue Agent Slater testified that his examination extended over a period of four or five days, and that he consulted with Goldstein regarding the books and records, has the effect, in substance, if not in form, of contradicting Goldstein in this regard. Slater also testified that, in his opinion, Goldstein was not cooperative. R. 574, 575. According to Slater, he performed his examination at the Southern Hotel and he had several discussions with Goldstein during his investigation. R. 574, 575.

Goldstein had corroborated Webb's testimony to the effect that the deductions entered on the daily sheets of the French Cafe were made each day, commencing with 1942 until July 6, 1946. Slater testified that at the time of his examination, in the latter part of 1946, he did not recall seeing either the daily sheets of the French Cafe or any entries of deductions reflected thereon. (Exhibits 20, 21, 22, 23, 24). R. 576.

Slater examined the ledger and cash journal receipts and disbursements in which Goldstein recorded all purchases for the various operations. Slater did not discover false entries or other evidence of fraud in these records. R. 580. According to Goldstein, the purchases for 1944 were overstated. R. 427-431 incl.

Relative to the private transactions of Respondent's witnesses, Petitioner was limited to deposits in their respective checking accounts exclusive of sums contained in their safe deposit boxes and amounts in their savings accounts. Although the Court below commented upon the deposits made by Webb and Goldstein in their bank accounts, it merely accepted their testimony as a justification for these large transactions; presumably, the Court observed no significance in other evidence bearing a close relationship to the deposits appearing in Webb's bank account as set forth in

the Court's opinion (R. 62). Specifically, this evidence is Exhibit 14, consisting of five checks drawn by Webb during the period of time he was preparing to enter into a partnership with the Decedent. The checks in question were drawn by Robert Webb, payable to W. F. Rau, Sr., on Mr. Rau's checking account; the name of W. F. Rau, Sr., was actually endorsed by Webb who received the proceeds thereof; Exhibit 14 consists of the following checks in the amounts and on the dates as indicated:

DATE	CHECK NO.	AMOUNT OF CHECK
April 7, 1947	753	$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
Total:		$7,300.00

The unusual deposits to Webb's bank account during this period are tabulated as follows (R. 62):

DATE	AMOUNT
May 27, 1947	$1,200.00
May 29, 1947	916.83
May 29, 1947	3,600.00
June 2, 1947	5,000.00
June 13, 1947	1,000.00

In Petitioner's view, the Court's explanation for the source of the deposits in Webb's bank accounts is lacking in realism and fails to take into account the evidence represented by Exhibit 14. If it is assumed that Webb had accumulated savings to the extent accepted by the Tax Court, and was planning to form a partnership requiring the contribution of $12,000.00, it is most peculiar that he would make five different deposits to his checking account and that he, at the same time, would draw checks on his employer's bank account and endorse the name of his employer and obtain the proceeds during the same months preceding the

formation of the partnership; the most damaging aspect of this testimony is that Respondent was unable to establish that the proceeds of the checks, so endorsed by Mr. Webb, were ever returned to the bank account of the Decedent. It is Petitioner's contention that the circumstances are not to be casually considered and then casually ignored; at least, Petitioner has demonstrated by positive, direct evidence the receipt of funds by Webb from the business bank account of his employer and has presented most cogent evidence that these same funds were subsequently deposited in the bank account of Webb. The Court below accepted far less credible evidence by accepting mere oral testimony of the very same witnesses whose private affairs are clothed with suspicion.

Relative to the bank deposits of Rose Goldstein, the Court below again disposed of this aspect by simply stating that such deposits represented income derived from her business; in its opinion, the Court below referred to such deposits and set forth a schedule reflecting some of these deposits on various dates from 1943 to 1947 (R. 63); the Court, however, failed to make any comment with respect to the deposits appearing under date of January 31, 1946, April 2, 1946 and May 9, 1946, in the respective amounts of $3,642.88, $1,000.00 and $1,150.00 (Note: These deposits are illustrative of Goldstein's testimony and do not exclude other deposits about which she testified). Goldstein testified that these particular sums represented receipts which she received from the preparation of income tax returns (R. 519). This testimony should be subjected to more than a cursory examination for this reason: in order to justify the deposit of $3,642.88 on the 31st day of January, 1946, Goldstein's fees for preparing income tax returns must have been enormous, or she must have prepared hundreds of returns at nominal charges; assuming that she received as much as $25.00 per return, it would have been necessary for her to prepare not less than 145 separate returns during

the month of January, 1946. According to her, she assisted Webb in his duties during the day as well as in the evenings (R. 473); the time remaining for her to discuss the returns with her clients and to assemble the information, excluding the computation of tax for 145 returns would exceed the hours available in each day for thirty consecutive days; it is submitted that her explanation for the source of such a large sum is unworthy of belief.

Having predicated its findings on inconsistent and contradictory testimony relating to alleged withheld receipts, envelopes, drawing of checks, payments in cash, depositing of funds, removing of cash from cash registers and the location of cash, the decision of the Court below is clearly erroneous and constitutes an arbitrary and capricious determination of Decedent's taxable income.

In making its determination, the Court below unhesitatingly adopted and approved the testimony of Respondent's witnesses, rejected the net worth, explained away highly questionable personal banking transactions of Respondent's witnesses, rejected the testimony of Decedent's witnesses as to which there is no evidence of a contradiction or an inconsistency. This, it is submitted, results in an improper and injudicious determination of the income tax liabilities of Petitioner's Decedent.

PART V. FRAUD

The real issue in this proceeding involves, of course, the question of fraud. The principle that fraud is never presumed, and that it must be established by "clear and convincing evidence" has long been recognized by this Court as well as others, in which this issue has been adjudicated.

It has also been held that, a deficiency in taxes, in, and of itself, is not sufficient for the purpose of sustaining the penalty under Section 293 (b), I.R.C. 1939. *Henry S. Kerbaugh,* 29 B. T. A. 1014, Aff'd. 74 Fed. 2d. 749, C. A. 1

(1935). In that case the Board of Tax Appeals refused to impose the fraud penalty, and, on that issue, Judge Van Fossan had this to say: "A charge of fraud has always been a serious matter in the law. Not only is it never presumed but the ordinary preponderance of evidence is not sufficient to establish such a charge. It must be proved by clear, convincing evidence." This principle finds support in the case of *Nicholson* v. *Commissioner,* 32 B. T. A. 977 (1935) Aff'd. 90 Fed. 2d 978. Notwithstanding the fact that the Petitioner, in that case, reported net income of $40,424.66, when, in fact, it was $73,435.38 for the year 1939, the Board of Appeals, in refusing to sustain the fraud penalty, said, that the deficiency, by itself, does not establish fraud. The Board also said, "If it did, then all taxpayers against whom deficiencies are determined would be guilty of fraud and subject to the imposition of the fraud penalty." It has also been held that "mere suspicion" is insufficient for the purpose of establishing fraud. This principle has been recognized in the law, not only as it relates to taxes, but in other fields as well. It was expressed by the Board of Tax Appeals in *William J. Schultze,* 18 B. T. A. 444 (1929). In that case, the Petitioner derived illegal income from bootlegging during the year 1920-1924. Despite the failure of the Petitioner to appear at the hearing, the Board of Tax Appeals rejected the fraud penalty and, in so doing, stated, "We may entertain whatever suspicions we choose, or infer whatever probabilities our imagination dictates, but to find a man guilty of fraud requires more than suspicion or mere probabilities of dereliction. . . .". Other decisions to the same effect are, *Sharpsville Boiler Works Co.,* 3 B. T. A. 568 (1925); *Arthur M. Godwin,* 34 B. T. A. 485 (1936); *Arthur S. Barnes,* 36 B. T. A. 764 (1937); *Nicholas Boerich,* 38 B. T. A. 567 (1938) Aff'd. 115 Fed. 2d. 39 (C A. D. C. 1940) cert denied, 312 U. S. 700 (1941); *L. Schepp Co.,* 25 B. T. A. 419 (1932).

It is well, at this time, to refer to the case of *Wiseley* v. *Commissioner,* 185 Fed. 2d. 263, decided by the Circuit Court of Appeals for the Sixth Circuit, reversing 13 T. C. 253. In that case, the Petitioner, a practicing physician, undoubtedly possessing a high degree of learning, maintained daily records of his income during the years 1942 to 1945 inclusive. Despite this, however, he reported approximately one-sixth of his actual income as established by his *net worth.* In reversing the Tax Court on the issue of fraud, the Court of Appeals attached considerable importance to the Petitioner's explanation that he was extremely busy during the war years and that he was under much strain in practicing his profession. Although this explanation was a self-serving one, the Court of Appeals was of the opinion that it was of sufficient weight to negate the charge of fraud.

In the present proceeding, the taxpayer was deceased and therefore unable to offer any explanation in refutation of the charge of fraud. That fact, it is submitted, deserves more than token consideration. The Tax Court has held that, although a Petitioner's explanation was inadequate, or even contradictory, such fact is not sufficient for sustaining Respondent's burden of proof on the issue of fraud; *Thomas Ferrara,* T. C. Memo Decision, 1-31-51, Docket No. 23274. To uphold such a charge under the circumstances prevailing herein would be tantamount to finding Mr. Rau guilty of a serious offense, by a hearing which would not be far removed from one in the nature of an ex parte proceeding. The fact that the Administrator of the Estate opposed the claim and exercised his right of cross examination, is of little comfort under such circumstances. The representatives of the Estate of Mr. Rau were denied the benefits of his testimony and, as the record shows, were confronted with such statements as "Mr. Rau instructed me", or "Mr. Rau was right there", or Mr. Rau "knew everything".

In the judicial concept, fairness connotes equal treatment. As such, it is the very basis upon which our system

of jurisprudence is founded. Is it fair, therefore, to find Mr. Rau guilty of fraud by reason of the fact that he was unable to defend himself against such charges? Is it fair that the income of the Decedent, as well as the disposition of his Estate, should be determined by accepting the mere utterances of such phrases as, "I was instructed", etc.? Who can now refute or contradict these patently self-serving declarations?

The evidence indicating the withholding of receipts may be assailed by referring to the testimony of Webb; according to him, the daily cash sheets of the French Cafe contained a total figure that was used as the receipts for each day; included in the grand total was an amount which had been arbitrarily added to the total amount which was then deposited in Decedent's bank accounts (R. 297, Line 23); Webb further testified that there were many occasions on which there were no deductions from or withholding of receipts (R. 296-311); again, Webb stated that he was instructed to make additions so as to make the deposits "look better by bringing them over $300.00" (R. 297-298).

The testimony of Webb relating to the entries appearing on the daily cash sheets is not clear and convincing for the purpose of establishing the withholding of receipts in the amount as determined by the Court below; there is considerable doubt that such bookkeeping gyrations actually accomplished any such withholding. It will be noted that these same records reflected arbitrary additions to income and that the amount of the deposits were used as receipts for each day. The fact that checks were issued to cash purporting to represent purchases of supplies does not justify the conclusion that receipts were withheld. Although purchases may have been duplicated to the extent that the checks did not, in fact, represent purchases, it should not be construed as withholding of receipts. In addition thereto, the issuance of checks to cash could have been a device employed by Webb and Goldstein in siphoning off funds be-

longing to their employer; unless Mr. Rau examined every invoice for which such checks were drawn, this method would escape detection. When consideration is given to these facts and circumstances, such a plan is not beyond the realm of possibility. While Petitioner has presented direct evidence as to the probable disposition of Decedent's funds, there is no duty upon Petitioner to "burn the house" in order to refute the method resorted to by Respondent in increasing Decedent's income in excess of that resulting from the net worth method.

CONCLUSION

It is respectfully prayed that the decision of the Tax Court be set aside; that the case be remanded with instructions to afford Petitioner the remedies provided by law; that the Tax Court be instructed to order the production of all records, including the income tax returns, savings accounts, contents of and record of entries into safe deposit boxes, real estate, stocks and bonds, loans and related data of Robert R. Webb and Rose Goldstein, in their names, or others acting as their agents, for each of the years 1942-1947 inclusive; that the fraud penalty be removed from all the years in question; and, that the Tax Court be directed to reach a decision based upon the law and the evidence.

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Of Counsel:

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APPENDIX

Statutes Involved

Section 7442, Internal Revenue Code, 1954, *Jurisdiction:*

"The Tax Court and its divisions shall have jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926."

Section 7482, Internal Revenue Code, 1954, *Courts of Review:*

"(a) Jurisdiction.—The United States Court of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code."

Section 7483, Internal Revenue Code, 1954, *Petition for Review:*

"The decision of the Tax Court may be reviewed by a United States Court of Appeals as provided in Section 7482 if a petition for such review is filed by either the Secretary (or his delegate) or the taxpayer within 3 months after the decision is rendered. If, however, a petition for such review is so filed by one party to the proceeding, a petition for review of the decision of the Tax Court may be filed by any other party to the proceeding within 4 months after such decision is rendered."

Section 1112, Internal Revenue Code, 1939, *Burden of Proof in Fraud Cases:*

"In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner."

Section 293(b), Internal Revenue Code, 1939, *Additions to Tax in Case of Deficiency:*

"If any part of any deficiency is due to fraud with intent to evade tax, then fifty per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty per centum addition to the tax provided in Section 3612(d)(2)."

Section 145(b), Internal Revenue Code, 1939, *Failure to Collect and Pay over Tax, or Attempt to Defeat or Evade Tax:*

"Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000.00, or imprisoned for not more than five years, or both, together with the costs of prosecution."

Section 2404, Title 28, U. S. Code:

"A civil action for damages commenced by or on behalf of the United States or in which it is interested shall not abate on the death of a defendant but shall survive and be enforceable against his estate as well as against surviving defendants." June 25, 1948.

Exhibit 1—A

ASSETS	As of 12/31/41	As of 12/31/42	As of 12/31/43	As of 12/31/44	As of 12/31/45	As of 12/31/46	As of 12/31/47
CASH:							
Bank of America, Bakersfield							
1. Southern Hotel	495.80	891.30	2,567.53	8,925.83	8,919.53	6,667.32	
2. Southern Wine & Liquor Store	789.75	4,512.62	17,419.68	8,932.06	20,520.55	2,489.39	
3. French Cafe	1,315.04	2,239.39	13,790.64	8,034.16	11,099.28		
4. W. A. Rau, Sr., Personal	4,366.01	5,096.20	4,440.81	2,278.23	4,261.84	2,931.57	9,458.18
5. W. A. Rau, Sr., Savings							50,000.00
Security 1st Nat'l. Bank, Ocean Park Branch, Venice							
6. Sea Spray Courts			841.50	2,155.24	4,251.36	1,559.53	3,285.77
7. Edmund Hotel				4,815.98	16,989.57	2,922.66	2,727.94
Bank of America, Taft							
8. Taft Hotel						1,636.76	
Anglo California Nat'l. Bank, Bakersfield							
9. W. A. Rau, Sr., Personal			3,823.28	831.58	2,345.78	27,723.28	
10. French Cafe, Partnership Interest							22,000.00
REAL ESTATE:							
11. Edmund Hotel, Venice—Land, Bldg. & Furnishings				91,500.00	91,500.00	91,500.00	91,500.00
12. Frame Building, 318 F Street, Bakersfield	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00
13. 2 Frame Buildings, 34 and 34½ Sunset, Venice	8,332.30	8,332.30	8,332.30	8,332.30	8,332.30	8,332.30	
14. Sea Spray Courts, Venice		25,000.00	25,000.00	25,000.00	25,000.00	25,000.00	25,000.00
15. Dwellings, 133 Brighton Way, Bakersfield					10,500.00	10,500.00	10,500.00
16. Dwellings, 521 Ocean Front, Venice			7,000.00	7,000.00	7,000.00	7,000.00	7,000.00
17. Lot 171 S. E. ½ 172, Culver City	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00
18. 15 acres Kern Co., California	750.00	750.00	750.00	750.00	750.00	750.00	750.00
19. Taft Hotel, Taft, California						70,000.00	
20. Mineral Rights, Norfolk, Virginia	50.00	50.00	50.00	50.00	50.00	50.00	50.00
21. Mineral Rights, San Luis Obispo Co., California	100.00	100.00	100.00	100.00	100.00	100.00	100.00
22. Buick Auto							2,357.99
23. Crypt, Bakersfield		760.00	760.00	760.00	760.00	760.00	760.00
24. Southern Hotel, F. & F.	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	
25. Southern Wine & Liquor Store, F. & F.	8,250.00	8,250.00	8,250.00	8,250.00	16,687.12	16,687.12	
26. French Cafe (Proprietorship)	8,250.00	8,250.00	8,250.00	8,250.00	8,250.00		
Total Assets	49,958.90	81,491.81	118,635.74	203,225.38	254,597.33	293,829.93	234,149.88

Exhibit 1—A (Continued)

LIABILITIES	As of 12/31/41	As of 12/31/42	As of 12/31/43	As of 12/31/44	As of 12/31/45	As of 12/31/46	As of 12/31/47
MORTGAGES PAYABLE:							
27. 318 F Street, Bakersfield, California	1,093.30						
28. 133 Brighton Way, Bakersfield, California					7,117.44	6,277.44	
29. Taft Hotel, Taft, California						13,793.92	
30. Edmund Hotel, Venice, California				32,462.09			
31. 2 Frame Buildings, 34 & 34½ Sunset, Venice, California	4,233.28	1,562.21					
32. Sea Spray Courts, Venice, California		22,633.43	22,633.43				
DEPRECIATION:							
33. Taft Hotel, Taft, California						1,449.94	
34. Edmund Hotel, Venice, California				1,668.63	5,005.97	8,343.31	11,680.65
35. Sea Spray Courts, Venice, California		662.40	1,545.60	2,428.80	3,312.00	4,195.20	5,078.40
36. 2 Frame Dwellings, Venice, California	3,471.00	3,846.00	4,221.00	4,596.00	4,971.00	5,346.00	
37. Southern Hotel, Bakersfield, California, F. & F.	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	
38. Frame Building, Bakersfield, California	382.77	607.40	805.29	1,123.17	1,347.80	1,572.43	1,797.06
39. Southern Wine & Liquor Store & Bar, Bakersfield, California, F. & F.	5,775.00	6,600.00	7,425.00	8,250.00	8,531.24	9,374.95	
40. French Cafe	8,250.00	8,250.00	8,250.00	8,250.00	8,250.00		
Total Liabilities and Depreciation	31,805.35	52,761.44	53,480.32	67,378.67	47,135.45	59,003.19	19,356.11
Net Worth	18,153.55	28,730.37	65,155.22	135,913.20	207,508.89	234,933.25	215,660.28
Net Worth Increase		10,576.82	36,424.85	70,757.98	71,595.69	27,424.36	(19,272.97)
Add:							
Federal Income Taxes Paid		345.06	6,254.03	6,995.32	27,638.93	51,708.95	50,171.67
Living Expenses		3,665.76	3,553.32	3,793.81	3,620.22	3,969.03	4,702.73
Long Term Capital Loss							(2,779.02)
Capital Loss (Partnership)							(2,141.14)
Adjusted Net Worth Income		14,587.64	46,232.20	81,547.11	102,854.84	83,102.34	30,681.27
Income Reported—Including Prior Adjustments		10,680.46	38,707.31	41,342.64	45,459.76	89,560.84	32,435.39
Additional Net Income on Net Worth Basis		3,907.18	7,524.89	40,204.47	57,395.08	(6,458.50)	(1,754.12)

No. 16823

In the United States Court of Appeals for the Ninth Circuit

ESTATE OF WALTER F. RAU, SR., DECEASED, RAYMOND J. SHORB, ADMINISTRATOR WITH THE WILL ANNEXED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 46–68) have not been officially reported.

JURISDICTION

This petition for review (R. 89–91) involves deficiencies in income taxes and the 50 percent fraud penalty for each of the years 1942 through 1947, inclusive. On January 17, 1956, the Commissioner of Internal Revenue mailed to petitioner on review a statutory notice of deficiency in income taxes aggregating $148,785.22 and penalties aggregating $83,255.47. (R. 9.) Within ninety days thereafter, or

on March 20, 1956, a petition was filed with the Tax Court for a redetermination of the deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 3, 6–9.) By amended answer (R. 41–43), the Commissioner claimed additional deficiencies for the years 1943 through 1946, inclusive, aggregating $39,895.12 in tax and $19,947.57 in additions to tax for fraud (R. 46). The decision of the Tax Court was entered September 25, 1959. (R. 88.) The case is brought to this Court by a petition for review filed December 23, 1959. (R. 89–91.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court upon the record was justified in upholding in principal part the Commissioner's determination of deficiencies in income tax for the taxable years involved.

2. Whether the Commissioner was bound to rely upon the net worth method in determining the income of decedent for each of the years under review or whether he was entitled to determine decedent's income by the use of specific omissions from the income returned which were clearly established.

3. Whether the Commissioner fully sustained his burden of proving that a part of the deficiency for each of the taxable years was due to fraud with intent to evade tax, thereby sustaining the 50 percent addition to tax and lifting the bar of the statute of limitations as to the years 1942–1944.

4. Whether the addition to tax pursuant to Section 293(b) of the Internal Revenue Code of 1939 for each

of the years involved survives the death of the taxpayer.[1]

STATUTES AND RULE INVOLVED

These may be found in the Appendix, *infra.*

STATEMENT

The findings of fact of the Tax Court (R. 47–64), based partially upon stipulated facts and exhibits which were incorporated in the findings by reference, may be summarized as follows:

Taxpayer, Walter F. Rau, Sr., who was declared incompetent by court order on May 12, 1952, died on January 4, 1953, when approximately 78 years of age. On March 9, 1955, Raymond J. Shorb was appointed as administrator with the will attached. At the time of his death, the taxpayer, hereinafter referred to as the decedent, was a widower, his wife having died on December 27, 1942. He filed a separate return for 1942 on a community property basis. His individual returns for all the taxable years were filed with the Collector of Internal Revenue at Los Angeles, California. (R. 47.)

Commencing in 1932, and continuing to August 7, 1947, decedent, as sole proprietor, operated a business known as the Southern Hotel in Bakersfield, California. In addition, he owned and operated the French Cafe and the Southern Wine and Liquor Store (hereinafter sometimes referred to as the Southern

[1] The petitioner failed to raise this issue in his pleadings below and first made reference to it in his brief. Although this issue will be considered in this brief, we submit that it was improperly raised (R. 68) and is therefore not properly before this Court on appeal.

Bar or the Southern Wine and Liquor Bar), located in the Southern Hotel. The French Cafe was operated as a sole proprietorship from 1934 until May 6, 1946, at which time decedent formed a partnership with one Phil Bender to operate that business. This partnership was terminated on August 16, 1947. On June 1, 1947, an equal partnership consisting of decedent, Phil Bender, and Robert R. Webb, manager of the Southern Hotel and employed by decedent since 1932, was formed for the purpose of conducting a business also known as the French Cafe in the vicinity of the Southern Hotel. This business continued in operation through 1947. The Southern Bar was owned and operated solely by decedent from 1934 to August 12, 1947. (R. 47–49.) Beginning in 1944, and continuing through the years in question, decedent owned and operated the Edmund and Sea Spray Hotels in Venice, California. In June, 1946, decedent purchased the Taft Hotel in Taft, California, which he operated, together with its restaurant and bar, from that date throughout the remainder of the period here involved. (R. 48.)

The books and records of the French Cafe, Southern Hotel and the Southern Bar were maintained on the cash basis of accounting under a single entry method of bookkeeping for decedent (R. 48) by Rose Goldstein Longway (hereinafter referred to as Rose Goldstein) from 1935 to August, 1947, when the Southern Hotel was demolished. Her services as bookkeeper for the French Cafe ceased on May 6, 1946, when decedent formed a partnership with Phil Bender. For her services, Rose Goldstein received $10 per

month, one or two meals a day, and desk space in the lobby of the hotel where she conducted a business of her own realizing income from services rendered as a public stenographer and notary public, and from mimeographing, telephone answering, direct mail advertising, and income tax return preparation. (R. 49–50.)

Robert Webb, as manager of the Southern Hotel, was charged with the duty of hiring and supervising bellboys and maids, keeping order in the hotel, and acting as room clerk. He also, at all times material herein, had charge of the receipts of the French Cafe and Southern Bar although he had nothing to do with the conduct of these businesses. (R. 49.) For his services, Webb received $100 per month plus room and board until 1945 when his salary was increased to $45 a week. He also received illegal income in 1940 and 1941 in the form of commissions on bets on horse racing, using a telephone in the Southern Hotel for this operation. On some days he received as much as $15 as his commission until his business was taken away from him against his will. (R. 49.)

Every morning during the years 1942 to May 6, 1946, when Webb reported to work, the steward or the cashier of the French Cafe would bring him a sheet containing figures showing the receipts for the preceding day, the cash register tape, and the cash receipts. The amount of daily receipts as shown on the cash register tape would be entered at the top of the sheet and from this amount there would be deducted "payouts" for the expenses of the day. Fol-

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lowing instructions received by him from decedent, Webb would deduct and remove from the net receipts $10 every day of the month and in addition thereto $100, $150, or $200, on Saturdays, Sundays and holidays. (R. 51–52.)

The $10 deducted by Webb each day from the net receipts of the French Cafe was under the decedent's instructions inserted in an envelope marked "French Cafe" which was kept in decedent's safe. At the end of the month the envelope would contain an amount ranging from $280 to $310 depending on the number of days in the month. Webb would then take the amount out of the envelope and give it to the decedent who would have it deposited in his personal bank account or put it in his safe deposit box at the Anglo California National Bank or would put it in his pocket. When the money was removed, the envelope would be destroyed, and Webb would start the next month with a new envelope. (R. 52.) The larger amounts deducted from cash receipts on Saturdays, Sundays and holidays were placed in another envelope marked "French Cafe" and on the outside of this envelope Webb would note the date of the deduction and the amount which decedent instructed Webb to deduct. (R. 52–53.)

At times, after deducting the usual $10 or the larger amounts from the net receipts of the French Cafe, the resulting figure would be below $300. Webb was instructed by decedent in such instances to make out a check, drawn upon the account of the French Cafe, payable to cash in an amount which, when added to the receipts as thus reduced would produce a figure

in excess of $300. Although the addition of the amount of the check to the net receipts for the day increased the receipts and the deposit for that day by that amount, the increase was neutralized for tax purposes by the fact that the amount of the check was falsely entered on the check stub as an expenditure for supplies and was entered on decedent's books pursuant to instructions from decedent and Webb as such an expenditure by the bookkeeper for each of the years 1942, 1943, 1944, 1945, and up to May 6, 1946. (R. 53.)

The Southern Bar operated on two shifts. Webb would receive the cash receipts from the two shifts from the respective bartenders and would then total the cash receipts for the day and deduct the amount of "payouts" for expenses. The decedent instructed him to deduct and remove each day from the net receipts thus determined the amount of $25. The $25 daily withdrawals, beginning in 1942 and continuing until a short time before the Southern Bar was closed in August, 1947, were inserted in an envelope marked "Bar" which was placed in the safe. Decedent also instructed Webb to deduct an additional larger amount on Saturdays, Sundays and holidays and this practice was followed from October, 1942, to at least July, 1947. This amount varied between $100 and $200, depending on the size of the receipts, and were placed in the comparable envelope for similar deductions made on such days from the receipts of the French Cafe. (R. 54.) When Webb was absent, Rose Goldstein handled the receipts of the French Cafe and the Southern Bar. On these occasions, the

same deductions were taken from the daily and week-end receipts of the businesses as were taken by Webb when he was present. Decedent told her the amounts to be taken as deductions. (R. 54–55.)

Decedent had bank accounts in the Bank of America National Trust and Savings Association, Bakersfield, California, for the French Cafe, Southern Bar, and the Southern Hotel, and also a bank account for the French Cafe in the Anglo California National Bank, Bakersfield, California. He had a personal account and a safety deposit box at the Anglo Bank. Webb was authorized by the decedent to draw checks on the bank accounts of the French Cafe and Southern Bar and he drew checks on these accounts to meet payroll and other expenses. (R. 50.) Practically all of the deposits for all of the taxable years to the various bank accounts of decedent's businesses, including those to his personal bank account, were made by Webb in the form of cash and checks. Webb went to the bank every day, sometimes three or four times a day, to make deposits. The amounts deposited as the receipts of the French Cafe and the Southern Bar were entered daily during the years 1942 through 1947, in "year books", consisting of a diary-type volume for each year with a half page or page for each day of the year. (R. 51.) Decedent sometimes gave Webb cash and told him to convert the cash into thousand dollar bills. Decedent would put these bills in his safe deposit box at the Anglo Bank. On one occasion when Webb accompanied decedent to the bank, decedent had twenty $1,000 bills when he returned from a visit to the box and bought $20,000 worth of war bonds.

Decedent told Webb he made this purchase and Webb saw him make it. (R. 51.)

The receipts of the French Cafe and the Southern Bar were recorded daily by Webb and, in his absence, by Rose Goldstein in "year books" during the years 1942 through August 10, 1947. The year books did not reflect the actual receipts for the businesses during those years because of the daily understatements of income set forth *supra*. (R. 55.) In addition, the receipts that were recorded on the daily sheets of the French Cafe and in the year books were always reduced by amounts actually paid out in cash for supplies. (R. 56.) Upon instructions from the decedent, the cash journal of the French Cafe reflects cash purchases for the years 1943 in the amount of $17,872.79, 1944 in the amount of $24,140.70, 1945, in the amount of $1,279.14, and 1946 in the amount of $1,969.91, which had already been deducted from receipts on the daily sheets, resulting in a duplication and overstatement of cash purchases. Over and above the overstatement of purchases shown in the cash journal, decedent instructed Rose Goldstein to "boost" fictitious purchases on his individual income tax returns so that purchases for the French Cafe which are shown in the cash journal to be in the amounts of $48,339.67 for 1943 (already overstated by $17,872.79) and $45,906.93 for 1944 (already overstated by $24,140.70) are shown on the individual income tax returns of decedent in the amounts of $66,791.12 for 1943 and $55,944.92 for 1944. (R. 57, 59.)

The decedent's income tax return for 1943 shows an opening inventory for the French Cafe of $3,500 and

a closing inventory of $1,050, and an opening inventory for the Southern Bar of $16,452.65 and a closing inventory of $1,695. His income tax return for 1944 shows an opening inventory for the Southern Bar of $1,695 and a closing inventory of $3,050.62. Actual inventories were not kept for the French Cafe or for the Southern Bar for the years 1943 and 1944 and the books and records of the French Cafe and Southern Bar do not reflect that inventories were kept for those years. The inventory figures that were used by the bookkeeper to determine income were given to her by the decedent without any verification. (R. 58.)

Decedent habitually used alcoholic beverages and at times drank to excess. During the period August 24, 1942 to September 21, 1945, he visited a doctor at least six times and was treated for alcoholic neuritis, arthritis, thrombophlebitis and myocarditis. (R. 60.) In the latter part of 1945, decedent was confined to his rooms in the Southern Hotel for a period of three weeks under care of a practical nurse. At the end of the three-week period he had difficulty walking and was in a wheel chair for a short time. Webb was almost a daily visitor to decedent's room during the three-week period. (R. 60.) In 1946 decedent and his nurse moved from the hotel to a house which decedent had purchased. Thereafter, until he had a stroke in December of 1947, he visited the hotel practically every day for a short period of time. (R. 61.) At all times material herein, the decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar, checked on the daily receipts and payouts of these businesses, gave in-

structions as to daily and week-end withdrawals from the receipts of these businesses, made it a practice to know everything that was going on, and closely supervised the affairs of these businesses. During the years 1942 through 1946, and until he had a stroke in December, 1947, he was mentally alert and had a keen mind insofar as his businesses were concerned. (R. 61.)

Webb had a personal checking account in the Bank of America during the years 1942 through 1947, and maintained a safe deposit box in that bank where he kept cash. He never deposited any of the receipts from the French Cafe or the Southern Bar in his bank account. (R. 61–62.) Rose Goldstein's total deposits in her personal bank account, representing income derived from her business during the years 1943 through 1947 aggregated $40,339.28. (R. 62–63.)

Decedent followed a consistent pattern of deliberately understating receipts of the French Cafe for 1942 to May 6, 1946, inclusive, and of the Southern Bar for 1942 to August 10, 1947, inclusive. He deliberately overstated purchases for the French Cafe in 1943, 1944 and 1945, despite repeated objections by his bookkeeper. (R. 64.) Decedent caused such books and records as were kept on his behalf to omit specific items of income for the years 1942 to 1947, inclusive, and to overstate specific items that reduced income for the years 1943, 1944 and 1945. He caused false entries to be made in his books and records for the years 1942 to 1947, inclusive. (R. 64.) Decedent filed false and fraudulent income tax returns for the taxable years 1942 to 1947, inclusive, and part of the

deficiencies for each of these years was due to fraud with intent to evade tax. (R. 64.)

The Tax Court found that the Commissioner's proof overwhelmingly established fraud and that the testimony of Robert Webb and Rose Goldstein was strong and convincing, and was in part corroborated by documentary evidence. (R. 64.) It further found that the specific items furnished a more accurate guide to the computation of decedent's net income than the net worth statement presented to the Court (R. 66) and that the Commissioner's adjustments (including those embodied in his amended answer) as to each item in controversy, with the exception of certain receipts from the Southern Bar for the year 1942, were strongly supported by the evidence (R. 65). The decision of the Tax Court pursuant to its prior findings of fact and opinion determined the following deficiencies and penalties against decedent for the taxable years involved (R. 88):

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$5,901.47	$2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

SUMMARY OF ARGUMENT

The Commissioner of Internal Revenue determined deficiencies in income taxes against the decedent for the taxable years 1942 through 1947, inclusive, and further determined that decedent had filed false and fraudulent returns for these years with an intent to

evade tax. In making his determination of income for the entire period under review the Commissioner relied upon specific omissions from taxable income. Except for a minor portion of the deficiency for 1942, the deficiencies determined by the Commissioner were approved by the Tax Court. The findings of the Tax Court should be affirmed unless clearly erroneous.

Petitioner objects to the reliance by the Tax Court, in determining decedent's income, in part, upon the testimony of two of decedent's former employees. Instead, the petitioner asserts, the Commissioner should have relied upon a net worth statement, stipulated to by the parties, which disclosed a lesser tax liability. The Tax Court noted that the net worth statement itself shows substantial amounts of unreported income, although less than those determined by the Commissioner's specific adjustments, and, moreover, that there is no rule of law requiring the use of a net worth statement. It found that, on the record, the evidence as to specific items furnished a more accurate guide to the computation of decedent's net income than the net worth statement.

With respect to petitioner's objection that the testimony of the Commissioner's witnesses was unworthy of belief by virtue of the fact that they possibly diverted decedent's funds to themselves, the Tax Court found that the main thrust of their testimony was credible, consistent, powerful, and persuasive and that it had no doubt on the evidence that, pursuant to explicit instructions of the decedent, false and fraudulent returns were prepared which understated receipts and overstated purchases.

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Decedent's returns in comparison with the determination made by the Commissioner as adjusted by the Tax Court, or, even in comparison with the net worth statement which petitioner urges should have been relied upon by the Commissioner, show a consistent pattern of under-reporting income in all the taxable years before this Court. Decedent specifically failed to report as income a pre-determined amount of receipts from the French Cafe and the Southern Bar, overstated his purchases for the French Cafe, omitted additional receipts from his businesses on weekends and holidays, and reported non-existent inventories on his tax returns. The Commissioner fully sustained his burden of proving that a part of the deficiency for each of the taxable years was due to fraud with intent to evade tax, thereby sustaining the 50 per cent addition to tax and lifting the bar of the statute of limitations as to the years 1942–1944.

The addition to tax pursuant to Section 293(b) of the Internal Revenue Code of 1939 for each of the years involved survives the death of the taxpayer.

ARGUMENT

I

The Tax Court, upon the record, was justified in upholding in principal part the Commissioner's determination of deficiencies in income tax for the taxable years involved

The Commissioner's determination of a deficiency is presumptively correct. *Helvering* v. *Nat. Grocery Co.,* 304 U.S. 282; *Helvering* v. *Taylor,* 293 U.S. 507; *Goe* v. *Commissioner,* 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Snell Isle, Inc.* v. *Com-*

missioner, 90 F. 2d 481 (C.A. 5th), certiorari denied, 302 U.S. 734. The burden of overcoming this presumption is upon the taxpayer. Here, the Tax Court concluded that the petitioner had failed to meet this burden except as to a minor portion of the 1942 deficiency.

It is a well accepted principle that the Tax Court's findings will not be disturbed upon review except when clearly erroneous; here, it is submitted, the record amply sustains them. The Tax Court based its conclusions in the instant matter in part upon its appraisal of the credibility of witnesses and their testimony and in part upon the records maintained on behalf of the decedent. It has long been established that upon review, due regard is given to the opportunity possessed by the trial court to appraise the credibility of witnesses. *United States* v. *Gypsum Co.,* 333 U.S. 364, rehearing denied, 333 U.S. 869; *Baumgardner* v. *Commissioner,* 251 F. 2d 311 (C.A. 9th); *National Brass Works* v. *Commissioner,* 205 F. 2d 104 (C.A. 9th); *Ferrando* v. *United States,* 245 F. 2d 582 (C.A. 9th); *Staudt* v. *Commissioner,* 216 F. 2d 610 (C.A. 4th); *Hague Estate* v. *Commissioner,* 132 F. 2d 775 (C.A. 2d), certiorari denied, 318 U.S. 787; Rule 52(a), Federal Rules of Civil Procedure; Section 7482(a) of the Internal Revenue Code of 1954 (Appendix, *infra*) (the successor to Section 1141(a) of the 1939 Code). In the light of the record before it, the Tax Court was fully justified in upholding in principal part the Commissioner's determination of deficiencies for the taxable years involved.

However, the petitioner now asserts in this Court that the testimony of decedent's former employees is not an acceptable basis for determining the income tax liabilities of the decedent. (Br. 14.) But this position of the petitioner is clearly without foundation.

The crux of Webb's and Goldstein's testimony relates to the control which decedent exercised over the conduct of his businesses. They testified that at all times material herein the decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar (R. 105–106, 503–504), checked on the daily receipts and payouts of these businesses (R. 105–106, 367–369, 376–377, 486–488), gave instructions as to the daily and week-end withdrawals from the receipts of these businesses (R. 110, 117–121, 144–145, 362–363, 443–448, 464, 482–485), made it a practice to know everything that was going on (R. 463–464), and closely supervised the affairs of these businesses. (R. 448–452, 538.) During the years 1942 through 1946, and until he had a stroke in December, 1947, he was mentally alert and had a keen mind insofar as his businesses were concerned. (R. 149–150, 463–465.)

The books and records of the businesses supplement the testimony of the witnesses. The entries in the year books, the cash journals, the checkbooks, and the daily sheets all disclose inconsistencies and understatements of income in the decedent's individual income tax returns. (R. 130–131, 440–462, Stip. B, Exs. D–I, M–V.) The petitioner cannot deny the existence of these inconsistencies and understatements. (R.

436, 529.) He instead alleges that Webb and Goldstein possibly made these entries for the purpose of concealing a plan of embezzlement. (Br. 15.) If that were so, petitioner failed to offer any evidence whatsoever to substantiate his allegation and we submit that there is no evidence in the record that Webb and Goldstein ever received any of the funds that were withheld from the receipts of the French Cafe or the Southern Bar. Moreover, what benefit would accrue to the would-be embezzlers by falsifying inventories on decedent's individual income tax returns for 1943 and 1944? These returns show opening and closing inventories for the French Cafe and Southern Bar although actual inventories were not kept for those businesses and their books and records do not reflect that inventories were kept for those years. (R. 502, 536–538, Exs. E–F.) Again, what benefit would Webb and Goldstein receive from duplicating cash purchases on decedent's returns? The cash journals for the French Cafe show amounts totaling $17,872.79 for 1943, $24,140.70 for 1944, $1,279.14 for 1945, and $1,969.91 for 1946, representing cash purchases of the French Cafe. These amounts were reflected in purchases when the income tax returns were prepared, even though they had already been subtracted from the receipts of the French Cafe for the years 1943–1946. (R. 448–452, 461–462, Exs. E–H, M, V.) Furthermore, decedent's income tax return for 1943 reports purchases for the French Cafe in the amount of $66,791.12, although the cash journals disclose an already inflated sum of only $48,339.67. (R. 440–442, Exs. E, O, U.) In 1944 the return reports purchases

of $55,944.92 despite the cash journals' total, again inflated, of $45,906.93. (R. 427–431, Exs. F, N, V.) Certainly Webb and Goldstein could realize no gain from these falsifications.

In its brief before this Court, the petitioner further seeks to discredit the Commissioner's witnesses, Webb and Rose Goldstein, by alleging the existence of inconsistencies in their testimony. For example, he attempts to confuse Webb's testimony with respect to the envelopes containing withdrawals of $10 and $25 per day with his testimony regarding the envelope containing larger amounts withheld on week-ends and holidays. (Br. 16–17.) However, the record clearly discloses the consistency of Webb's testimony. Decedent never touched the envelopes containing the $10 and $25 until the end of the month. (R. 128, 353–354.) At times, however, decedent would take money out of the envelope containing the *larger* amounts withheld on week-ends and holidays so that there would be no cash left at the end of the month. (R. 128–129, 193–197, 353–354.) Again, there is no inconsistency in Webb's testimony with regard to the writing of "French Cafe" on the envelope (R. 195–197), the times at which he picked up or received the receipts and the register tapes from the Southern Bar (R. 175–178), the mental condition of decedent (R. 149–150), and the falsification of the daily sheets from the French Cafe. (R. 110, 117–121, 144–147.)

Webb's testimony with regard to the issuance of checks clearly establishes that decedent instructed Webb to make checks out to cash which were added to the daily receipts of the French Cafe and to mark

the check stub "supplies". As a result, decedent increased the receipts for the day to make them look "respectable" while at the same time neutralizing the effect of additional income reflected in the receipts by deducting the amount, fictitiously spent on "supplies", from income. (R. 300, 434–438.)

Petitioner cites additional contradictions which it allegedly finds in Webb's and Goldstein's testimony. A reading of the record will disclose that these alleged contradictions do not exist, that in many instances the witnesses' testimony has been taken out of context or their replies were misinterpreted by counsel for petitioner. Furthermore, many conclusions drawn by petitioner from the testimony of the witnesses do not logically follow. For example, petitioner lays great stress upon the asserted fact that Webb was "very vague and indefinite" as to when he received the receipts from the French Cafe and the Southern Bar and what he did with them. (Br. 18, 26–27.) The record shows that Webb clearly set out the procedure followed in collecting receipts. (R. 174–177.) Petitioner interprets decedent's instructions to Webb to increase the daily receipts by adding to them a check payable to cash as increasing the bank balances. (Br. 20.) But as indicated above, the record makes it clear that this practice was neutralized for tax purposes by marking the check stubs to indicate that these amounts were expended for supplies. (R. 300, 434–438, Ex. T.)

Further, petitioner quotes Webb as testifying to decedent's health in contradictory terms. (Br. 23.) He neglects, however, to point out the context in

which his replies were made. (R. 149–151, 183–184.) Nowhere in the record does it appear that decedent did not have complete use of his faculties, at least until December of 1947. None of petitioner's witnesses were able to rebut the direct testimony of Webb and Goldstein that decedent kept in daily touch with the affairs of his businesses either by personally coming downstairs to look over the books and records, during the earlier years, or having the records brought to him by Webb or being driven over to the hotel by his nurse during the later years. (R. 389, 410–411, 552–565.) There is no question about decedent's mental capacity in 1942 when the scheme to withhold receipts was set up and this scheme was used until August 1947 when the hotel was demolished.

II

The Commissioner was not bound to rely upon the net worth method in determining the income of decedent for each of the years under review but was entitled to determine decedent's income by the use of specific omissions from the income returned which were clearly established

Petitioner admits that there are deficiencies to the extent of the alleged increase in net worth during the taxable years and contends that in the determination of such deficiencies the Commissioner should have used the increase in net worth method rather than relying upon specific omissions from income. (Br. 9–11.)

Section 41 of the Internal Revenue Code of 1939 (Appendix, *infra*) provides generally that the determination of income shall be upon the basis of the method of accounting regularly employed in keeping

the books, but where the method employed does not clearly reflect income or where proper records are not kept or are lost "the computation shall be made in accordance with such method as *in the opinion of the Commissioner* does clearly reflect income." (Italics supplied.) The choice as to which method of computation of income shall be applied in a situation such as this, wherein no books are produced or inaccurate books have been kept, rests not with the petitioner but with the Commissioner. *Halle* v. *Commissioner,* 7 T.C. 245, 250, affirmed 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Miller* v. *Commissioner,* decided April 29, 1955 (1955 P–H T.C. Memorandum Decisions, par. 55,112), affirmed on this point, 237 F. 2d 830, 838 (C.A. 5th); *United Dressed Beef Co.* v. *Commissioner,* 23 T.C. 879, 885; *Funk* v. *Commissioner,* 29 T.C. 279, 293, affirmed *sub. nom. Furnish* v. *Commissioner,* 262 F. 2d 727 (C.A. 9th); *Schira* v. *Commissioner,* 240 F. 2d 672 (C.A. 6th); *Stone* v. *Commissioner,* 22 T.C. 893, 904. The same contention made by petitioner herein was raised in *Schellenbarg* v. *Commissioner,* 31 T.C. 1269. The Tax Court held as follows (p. 1277):

> In a further effort to substantiate their position, petitioners claim that respondent failed to utilize an accepted method of reconstructing income pursuant to the authority granted him by section 41 of the 1939 Code. They maintain that at least four separate methods were open to him, all of which he chose to disregard, i.e., increases in net worth, analysis of bank deposits, percentage markup, and the personal

> expenditures method. Section 41 of the Code provides, in the event the method of accounting utilized by the taxpayer does not clearly reflect income, that "the computation shall be in accordance with such method *as in the opinion of the Commissioner* does clearly reflect the income." (Italic supplied.) It is thus apparent that the choice as to the method of reconstruction to be employed lies with the Commissioner, and not the taxpayer, the only restriction being that the method adopted be reasonable.

The Tax Court found, and properly so, that on the present record the evidence as to specific items of understated income and overstated deductions furnishes a more accurate guide to the computation of decedent's net income than the net worth statement. (R. 66.) This is particularly so in view of the existence of a safety deposit box which decedent maintained at the Anglo Bank and in which he deposited cash and bonds in large sums. (R. 179, 190–192.) The petitioner's query as to where is the sum of $131,000 (Br. 15), which reflects the difference between the understatement disclosed by the evidence relating to specific items and the understated income disclosed by the net worth statement, is readily answerable by reference to the safety deposit box whose contents are not included in the net worth computation. (Br. 41–42).

Petitioner obviously overlooks the fact that the net worth technique of computing income is not a method of accounting. It is no more than proof of income by circumstantial or indirect evidence. *Davis* v. *Commissioner,* 239 F. 2d 187, 188 (C.A. 7th); *Baum-*

gardner v. *Commissioner,* 251 F. 2d 311 (C.A. 9th). The Tax Court properly relied upon the testimony of the witnesses and the records and books presented in evidence to arrive at its determination of deficiencies in tax and additions to tax for fraud. The weighing of all the evidence concerning the disputed amount and the translating of it into an actual monetary figure is a proper judicial function well recognized by the courts. *Bodoglau* v. *Commissioner,* 230 F. 2d 336 (C.A. 7th); *Baumgardner* v. *Commissioner, supra; Commissioner* v. *Thompson,* 222 F. 2d 893 (C.A. 3d); *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d).

We submit that, under the conditions present herein, the Tax Court correctly relied upon the Commissioner's evidence disclosing specific items of understated income and overstated deductions rather than the limited disclosure of unreported income afforded by the net worth method.

III

The Commissioner fully sustained his burden of proving that a part of the deficiency for each of the taxable years was due to fraud with intent to evade tax, thereby sustaining the 50 percent addition to tax and lifting the bar of the statute of limitations as to the years 1942–1944 [2]

The burden of proof of fraud rests upon the Commissioner. Section 7454(a) of the Internal Revenue Code of 1954 (Appendix, *infra*). In proving fraudulent intent the Commissioner has to show only that some part of each deficiency was due to fraud with intent to evade tax. Section 293(b) of the Internal

[2] No question as to limitations with respect to the remaining years is presently in issue.

Revenue Code of 1939 (Appendix, *infra*). As in the case of a factual determination such as the amount of the deficiency, it is a well accepted principle that a Court of Appeals will not disturb the Tax Court's findings as to fraud if they are supported by clear and convincing evidence. *Helvering* v. *Kehoe,* 309 U.S. 277; *Rose* v. *Commissioner,* 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Goe* v. *Commissioner,* 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Halle* v. *Commissioner,* 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Greenfeld* v. *Commissioner,* 165 F. 2d 318 (C.A. 4th). It is respectfully submitted that the Tax Court's finding of fraud in this case is amply supported by clear and convincing evidence and should be sustained. In the deficiency notice issued by the Commissioner it was determined that the decedent had fraudulently understated income in his income tax returns for each of the taxable years named in the deficiency notice. (R. 9–11.) In the proceeding in the Tax Court, it was found that decedent followed a consistent pattern of deliberately understating receipts of the French Cafe for 1942 to May 6, 1946, inclusive, and of the Southern Bar for 1942 to August 10, 1947, inclusive; that he deliberately overstated purchases for the French Cafe in 1943, 1944, 1945, and 1946 despite repeated objections by his bookkeeper, that he caused such books and records as were kept on his behalf to omit specific items of income for the years 1942 to 1947, inclusive, and to overstate specific items that reduced income for the years 1943, 1944 and 1945; and that decedent caused

false entries to be made in his books and records for the years 1942 to 1947, inclusive. (R. 55–60; 64.)

A comparison of the net income reported by decedent on his tax returns, the net income stipulated to by petitioner under the net worth method, and the net income determined by the Commissioner, as adjusted by the Tax Court's findings and the computation under Tax Court Rule 50 (Appendix, *infra*) for the taxable years under review, is as follows (R. 12–18, 81–87, Pet. Br. 42.):

	Income Reported	Net Worth Stipulation	Income determined under Rule 50 of the Tax Court
1942	$4,121.92	$14,587.64	$18,886.90
1943	17,859.24	46,232.20	104,904.18
1944	35,493.94	81,547.11	105,491.34
1945	44,959.76	102,854.84	100,649.59
1946	89,060.84	83,102.34	103,918.42
1947	27,371.48	30,681.27	53,940.57

It is obvious that there is a shocking disparity, not only between the net income reported by decedent in his tax returns and that determined by the Tax Court, but between the amount reported on the returns and the net income disclosed by the net worth statement stipulated to by the petitioner. A persistent failure to report large amounts of income over an extended period without more is strong evidence of fraudulent intent. *Holland* v. *United States,* 348 U.S. 121; *Smith* v. *United States,* 348 U.S. 147; *Furnish* v. *Commissioner,* 262 F. 2d 727, 728–729 (C.A. 9th); *Anderson* v. *Commissioner,* 250 F. 2d 242, 249–250 (C.A. 5th); *Lipsitz* v. *Commissioner,* 220 F. 2d 871 (C.A. 4th). Where, as here, the pattern of unrecorded and unreported income is accompanied

by specific evidence of fraud, the requisite intent to evade tax is unmistakably clear.

In the instant case the evidence of fraud permeates the record. Decedent specifically instructed Webb and Rose Goldstein to withhold $10 and $25 per day from the receipts of the French Cafe and the Southern Bar, respectively. He instructed them to deduct additional amounts of $100, $150 and $200 from the businesses on week-ends and holidays. (R. 110, 117–121, 144–147, 362–363, 443–448, 464, 482–485.)[3] He instructed his bookkeeper to duplicate purchases and to set up false inventory records. (R. 430, 435–436, 536–538.) During all the years involved herein, decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar (R. 105–106, 503–504), checked on the daily receipts and payouts of these businesses (R. 105–106, 367–369, 376–377, 486–488), made it a practice to know everything that was going on, and closely supervised the affairs of these businesses. (R. 448–452, 463–464, 538.) During the years 1942 through 1946 and until he had a stroke in December, 1947, he was mentally alert and had a keen mind insofar as his businesses were concerned. (R. 149–150, 463–465.)

The petitioner also contends that to find that the

[3] As the Tax Court noted in its opinion (R. 65 and fn. 2), the evidence would support adjustments of unreported income in excess of those determined by the Commissioner. This is so because the Commissioner restored to income $100 for each of the 104 Saturdays, Sundays and holidays in the pertinent years. He would have been justified in adding a further amount for those days in which more than $100 was withheld.

deceased fraudulently attempted to evade income taxes would be tantamount to finding him guilty of a serious offense in a hearing not far removed from one in the nature of an *ex parte* proceeding. (Br. 36–37.) He asserts that the fact that the administrator of the estate opposed the claim and exercised his right of cross-examination is of little comfort under such circumstances when decedent is not present to refute the testimony presented against him. In effect, petitioner is contending that fraud can never be fairly proven against a taxpayer where he has no opportunity directly to refute the evidence of fraud. This argument was presented by a decedent's estate in *Lee* v. *Commissioner,* 227 F. 2d 181 (C.A. 5th). The court there held as follows (p. 184):

> * * * though we agree with appellant that the inability of the taxpayer to confute or explain what unconfuted and unexplained has damaging weight, has to that extent increased the factual difficulties of the taxpayer and lessened those of the Commissioner, we are bound to hold that this consideration fully expends itself when giving it all the proper weight it is entitled to, we still cannot say, as we cannot here, that on the examination of the evidence as a whole we are left with the firm conviction that the findings were wrong and must be set aside.

We submit that on an examination of the evidence as a whole herein, it cannot be said that the Tax Court findings were wrong even after giving weight to petitioner's contention that decedent's absence hampered his case.

IV

The addition to tax pursuant to section 293(b) of the Internal Revenue Code of 1939 for each of the years involved survives the death of the taxpayer

The Tax Court in its opinion notes that the petitioner raised the issue of the survival of the fraud penalty imposed subsequent to the death of the taxpayer in its brief. No such issue was raised in the pleadings; therefore the court did not consider the issue to have been properly before it. (R. 68.) We respectfully submit that this issue, by virtue of petitioner's failure to raise it in his pleadings, is not properly before this court on appeal.

However, aside from the propriety of peitioner's contention at this date, the law is clear that unpaid federal taxes, including the 50 per cent addition to tax for fraud, do not abate upon the death of the taxpayer and they remain collectible from the assets of the taxpayer's estate. *Lee* v. *Commissioner,* 227 F. 2d 181, 183 (C.A. 5th); *Scadron's Estate* v. *Commissioner,* 212 F. 2d 188 (C.A. 2d), certiorari denied 348 U.S. 832; *Reimer's Estate* v. *Commissioner,* 12 T.C. 913, affirmed *per curiam,* 180 F. 2d 159 (C.A. 6th); *Briden's Estate* v. *Commissioner,* 11 T.C. 1095, 1135–1136, affirmed *sub. nom. Kirk* v. *Commissioner,* 179 F. 2d 619 (C.A. 1st); G.C.M. 22326, 1940–2 Cum. Bull. 159. The Tax Court in *Reimer's Estate* v. *Commissioner, supra,* in commenting on the history of Section

293(b) of the 1939 Code noted that in 1940 the Commissioner, relying upon the Supreme Court's decision in *Helvering* v. *Mitchell,* 303 U.S. 391, reversed his former position and held that the 50 per cent addition to tax for fraud does not abate upon the death of the taxpayer but is collectible from his estate. See G.C.M. 22326, 1940–2 Cum. Bull. 159. The Supreme Court had held in *Mitchell* that the assessment was not a criminal penalty and that, furthermore, it was not to be considered penal in any sense but rather a safeguard for the protection of the revenue and was intended to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud. Since the addition to tax is civil in nature, the Tax Court held that the remedy afforded the Government by the statute did not abate. This view was also taken by the Court of Appeals for the First Circuit in *Kirk* v. *Commissioner,* 179 F. 2d 619, 621, and was held to be the correct interpretation of the law by the Court of Appeals for the Second Circuit in *Scadron's Estate* v. *Commissioner, supra.*

The petitioner concedes (Br. 7–8) that the cases subsequent to *Briden's Estate* v. *Commissioner, supra,* have, in reliance upon *Helvering* v. *Mitchell, supra,* resolved this issue against the taxpayer. We submit that the petitioner's contention that the addition to tax on account of fraud abates upon the death of the taxpayer has no basis in law.

CONCLUSION

For the foregoing reasons, we submit that the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted.

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SEPTEMBER 1960.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be as assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

Internal Revenue Code of 1954:

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7454.)

SEC. 7482. COURTS OF REVIEW.

(a) *Jurisdiction.*—The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7482.)

Rules of Practice Before the Tax Court of the United States (Rev. to April 1, 1958):

RULE 50. COMPUTATIONS BY PARTIES FOR ENTRY OF DECISION

(a) *Agreed computations.*—Where the Court has promulgated or entered its opinion determining the issues in a case, it may withhold entry of its decision for the purpose of permitting the parties to submit computations pursuant to the Court's determination of the issues, showing the correct amount of the deficiency or overpayment to be entered as the decision. If the parties are in agreement as to the amount of the deficiency or overpayment to be entered as the decision pursuant to the report of the Court, they or either of them shall file promptly with the Court an original and 2 copies of a computation showing the amount of the deficiency or overpayment and that there is no disagreement that the figures shown are in accordance with the report of the Court. The Court will then enter its decision.

* * * * *

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 16,823

ESTATE OF WALTER F. RAU, SR., deceased, RAYMOND J. SHORB, Administrator with the Will Annexed, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petition for Review of Decision of the Tax Court of the United States

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

PRELIMINARY STATEMENT

Respondent filed its brief in this proceeding under date of September 9, 1960. This brief, in behalf of Petitioner, is in reply thereto.

Without conceding other arguments advanced by Respondent, Petitioner's reply will be directed to the substantive aspects involved herein.

Reply to: Summary of Argument

Notwithstanding the adoption thereof by the Tax Court, Respondent's characterization of oral testimony as "specific adjustments" is not only novel but it also lacks the judicial approval that has been accorded the net worth method upon which Petitioner relies in support of its position. Respondent ingeniously endeavors to justify its position in this regard by referring to the deficiencies resulting from the net worth method; apparently, so it seems, Respondent seeks to persuade this Court that this latter method is less reliable than the unsubstantiated oral testimony of Webb and Goldstein; the fact that the net worth method reflects deficiencies does not, in and of itself, warrant its rejection in favor of the oral testimony of Webb and Goldstein. Assuming, *arguendo,* that such justification existed, it cannot endure when consideration is given to the unusual personal financial transactions of Webb and Goldstein as demonstrated by the record.

Respondent's argument (B. 14) that the net worth statement shows a consistent pattern of under reporting income in all the taxable years before this Court is clearly erroneous; the net worth, as stipulated, reflects over reporting of income for the years 1946 and 1947 (Pet. App. 42).

Reply to: Argument

I

Petitioner does not dispute the rule of law announced in the cases of *Helvering* v. *Nat. Grocery Co.,* 304 U.S. 282; *Helvering* v. *Taylor,* 293 U.S. 507; *Goe* v. *Commissioner,* 198 F. 2d 851 (C. A. 3d), certiorari denied, 344 U.S. 897; *Snell Isle, Inc.* v. *Commissioner,* 90 F. 2d 481 (C. A. 5th), certiorari denied, 302 U.S. 734, cited by Respondent. Petitioner, however, does dispute the applicability of those decisions to the facts under review; Petitioner employed a method in determining income that has a long history of judicial approval as opposed to a means

not heretofore recognized or accepted as a method. The mere fact that the Tax Court found that the net worth method was less reliable than the oral testimony of two former employees does not, it is submitted, preclude the Petitioner from questioning the findings of that Court. This Court is vested with the power and authority to review and to set aside a finding which is clearly erroneous; indeed, this is the very essence of this review. It is Petitioner's contention that this finding of the Tax Court is not only clearly erroneous within the meaning of Rule 52(a), Federal Rules of Civil Procedure, but it is also arbitrary and capricious and is contrary to the law and the evidence.

Petitioner has no quarrel with the principle of law relating to the opportunity of the Trial Court to appraise the credibility of witnesses and is in full accord with such principle as expressed in the cases of *U. S.* v. *Gypsum Co.,* 333 U.S. 364, rehearing denied, 333 U.S. 869; *Baumgardner* v. *Commissioner,* 251 F. 2d 311 (C. A. 9th); *National Brass Works* v. *Commissioner,* 205 F. 2d 104 (C. A. 9th); *Ferrando* v. *U. S.,* 245 F. 2d 582 (C. A. 9th); *Staudt* v. *Commissioner,* 216 F. 2d 610 (C. A. 4th); *Hague Estate* v. *Commissioner,* 132 F. 2d 775 (C. A. 2d), certiorari denied, 318 U.S. 787.

In this regard, however, Petitioner questions the right of the Tax Court to abuse its discretion in appraising the credibility of witnesses whose trustworthiness and integrity have been seriously impugned by virtue of their highly suspicious personal financial transactions; even the Court below observed that Petitioner had generated "smoke" in that connection (R. 256); assuming, further, that Petitioner had only generated "smoke" relative to the possible defalcation of Decedent's funds in endeavoring to disclose the disposition thereof, is it not inconsistent to characterize the testimony of Webb and Goldstein as being "credible, consistent, powerful and persuasive"?

In criminal proceedings, it is well recognized that the testimony of an accomplice is subject to strict limitations

as to the credibility thereof; while the present proceeding is civil in nature, we have the admission of both Webb and Goldstein that they knowingly participated in the alleged falsification of records and, as to Goldstein, she admitted that she knowingly prepared the Decedent's income tax returns knowing them to be false at the time; these acts were performed by these individuals over a period of six years. Such conduct constitutes a felony under the provisions of Section 3793(b)(1), Internal Revenue Code, 1939; the fact that Webb and Goldstein testified that they were "instructed" to commit these felonies must, under the circumstances, be regarded as nothing more than self-serving declarations; it is incredible that two individuals, approximately forty years of age, would aid and abet the commission of a crime, year after year, while receiving a salary of $100.00 per month, in the case of Webb, and $10.00 per month in the case of Goldstein.

Under such conditions, it would seem that Respondent is not above criticism in predicating its determination of income on the testimony of two such individuals.

Respondent claims that the crux of Webb's and Goldstein's testimony related to the control which Decedent exercised over the conduct of his businesses (B. 16); while this might have been the crux of their testimony, that fact does not lend support to their credibility. Betty Dorsey, a witness called on behalf of Petitioner, was Decedent's practical nurse from the latter part of 1945 until his death in January, 1953; this witness testified that Decedent was not mentally alert or sharp; that Decedent was in poor health and devoted little time to his businesses (R. 539-563). The extent of Webb's control and his exercise of authority in the conduct of Decedent's businesses was commented upon by Respondent in its brief (B. 5-8). It is difficult to reconcile this portion of Respondent's brief with the fact that the Decedent, who was addicted to the excessive use of alcohol, in poor physical health, unable

to dress and undress himself, not mentally alert, subject to spells of weeping, was obviously incapable of close supervision in the conduct of his businesses; it is an undisputed fact that Webb and Goldstein were entrusted with the Decedent's several businesses and this fact cannot be avoided by accepting the testimony of Webb and Goldstein to the effect that Decedent was mentally sharp and that he exercised close supervision; the evidence overwhelmingly establishes that Webb and Goldstein dominated and controlled Decedent's businesses.

Respondent argues that Petitioner failed to offer any evidence whatsoever to substantiate the possible embezzlement of Decedent's funds by Webb and Goldstein (B. 17); in view of the very nature and extent of the financial transactions of Webb and Goldstein, keeping in mind Webb's salary of $100.00 per month and Goldstein's salary of $10.00 per month, and the nature of their duties, day and night, it is, quite frankly, incredible that Respondent would advance such an argument. Respondent has, it is submitted, secured numerous convictions for tax evasion on just this kind of evidence.

At this point, it is well to comment upon another fact about which Respondent has remained remarkably silent; specifically, it concerns Webb's testimony in connection with a check in the amount of $3,500.00 drawn by him and payable to cash or to himself; according to Webb, the check was drawn in 1942 and related to the purchase of a home by the Decedent located at 318 F Street, Bakersfield, California. Webb was very positive as to the year in which this transaction occurred; the net worth, however, as stipulated between the parties, reflects the purchase of this home at least by 1941 (R. 181-183). Once again, as in the case of the checks contained in Exhibit 14, Respondent has utterly failed to demonstrate that Decedent received the benefit of this check; Respondent has likewise failed to present any explanation for such highly

questionable transactions and has permitted the contradictions to remain unexplained. The record is completely devoid of any evidence relative to the final disposition of the sum of $3,500.00 represented by the check in question; the evidence merely shows that Webb received the proceeds, and nothing more.

Respondent seeks to refute Petitioner's contention relative to the whereabouts of Decedent's funds in excess of the net worth by injecting the question of inventories. While the purpose of Respondent in so doing is quite obvious, Petitioner has never contended that Webb and/or Goldstein derived any benefit by means of incorrect opening and closing inventories; Petitioner has contended, however, and still insists that Webb and Goldstein could very well have embezzled funds from their employer by means of the checks drawn to cash purportedly representing cash payments for supplies; Respondent cannot deny that all of such checks, over a period of six years, were drawn by Webb, in his handwriting, and that they were cashed by him at the bank for the alleged purpose of paying for supplies delivered to the French Cafe or to the Southern Wine and Liquor Bar. Petitioner claims that, unless Decedent, an alcoholic, weak and infirm, examined every invoice and reconciled the checks issued therefor, he could not possibly detect defalcations of his funds by Webb and Goldstein; at this juncture, it is interesting to observe that Respondent's brief is startlingly silent as to the final disposition of the funds obtained by Webb represented by the checks drawn by him to "cash"; specifically, Petitioner has reference to Exhibit 14 containing a group of checks bearing Decedent's name as drawer as well as endorser, both of which were inscribed by Webb himself; a listing of these checks appears on Page 32 of Petitioner's original brief. The principles of "fair play" impose upon Respondent the obligation of explaining the final disposition of these funds; the opportunity for so doing presented itself at the hearing and has persisted throughout the entire pro-

ceeding; as yet, however, Respondent has failed to offer any forthright explanation; these funds have never been traced to the possession of anyone other than Webb; nor, indeed, did Webb state that he gave the funds, represented by these checks, to Decedent at any time. Petitioner has presented direct evidence that unequivocably establishes that Webb was the only one who obtained the funds. It is elementary arithmetic, that, until Respondent demonstrates by probative evidence that these funds were returned to the Decedent, they cannot be taxable to Decedent.

With respect to Respondent's argument that Petitioner has intended to confuse Webb's testimony with respect to the envelopes containing alleged withdrawals (B. 18), Petitioner does not regard this as a matter of substance and relies upon the record in support of the contention that Webb's testimony is not only confusing as to the whereabouts of the funds which he received from the bartender at the French Cafe, but that, in the main, his testimony in this regard is contradictory as well; by way of comment, Counsel for Respondent at the hearing indicated his own confusion when he stated, "that this money was then laid there and Mr. Rau examined that together with the money in the envelope" (R. 174); Respondent also argues that Webb's and Goldstein's testimony has been taken out of context by Counsel for Petitioner; Respondent, however, fails to particularize an instance of this kind and, consequently, Petitioner is denied the opportunity of presenting an intelligent reply to such an argument.

Except for Respondent's argument relating to the issuance of checks to cash, the other arguments remaining under Part I of Respondent's argument do not involve substantive aspects and from the nature of such arguments, it is apparent that Respondent seeks to extricate its witnesses from their own web of confusion and contradictions. Respondent's argument that Webb's testimony with regard

to the issuance of checks "clearly establishes that Decedent instructed Webb to make checks out to cash . . ." (B. 18), is quite unique; first of all, in making the assertion, Respondent is obliged to rely upon Webb's testimony; this, in itself, in Petitioner's opinion, has little to recommend itself. As a matter of fact, Respondent's case depends upon the credibility of Webb and Goldstein plus the rejection of the net worth which was compiled from unbiased third party sources and agreed to by Respondent.

II

Respondent cites Section 41, Internal Revenue Code, 1939, whereby the Commissioner is authorized, in certain instances, to make computation of income in accordance with such method as "in the opinion of the Commissioner does clearly reflect income" to support the acceptance of oral testimony of Webb and Goldstein; it is here, that Petitioner vigorously objects to the designation assigned by Respondent to such oral testimony. Not one of the cases cited by Respondent in this connection involves facts remotely resembling those under review: *Halle* v. *Commissioner,* 7 T.C. 245, 250; affirmed 175 F. 2d 500 (C. A. 2d), certiorari denied, 338 U.S. 949; *Miller* v. *Commissioner,* decided April 29, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55, 122), affirmed on this point, 237 F. 2d 830, 838 (C.A. 5th); *United Dressed Beef Co.* v. *Commissioner,* 23 T.C. 879, 885; *Funk* v. *Commissioner,* 29 T.C. 279, 293, affirmed *sub. nom. Furnish* v. *Commissioner,* 262 F. 2d 727 (C.A. 9th); *Schira* v. *Commissioner,* 240 F. 2d 672 (C.A. 6th); *Stone* v. *Commissioner,* 23 T.C. 893, 904; *Schellenbarg* v. *Commissioner,* 21 T.C. 1269. Apparently, Respondent relies heavily upon the decision in *Schellenbarg* v. *Commissioner, Supra,* and quoted, in part, the decision of the Tax Court in that case (B. 21-22); the facts in *Schellenbarg* v. *Commissioner, Supra,* are so unlike those in the instant proceeding that they admit of no similarity whatsoever; in the Schellenbarg case the evidence clearly demonstrated

specific instances of omissions of sales based on the records of the Petitioner in conjunction with the records of the purchasers to whom the sales were made; the actual omission of sales and the failure of the Petitioner, in that case, to record them in his records was, therefore, established by the evidence. In the present proceeding, we have only the allegations of two employees that receipts were withheld; there is no evidence, whatsoever, showing that they were not ultimately deposited in Decedent's bank accounts or used in the acquisition of assets; furthermore, there is most potent evidence that the so-called, withheld receipts, found their way into the possession of Webb and Goldstein. It is well to refer to that part of the Tax Court's opinion in *Schellenbarg* v. *Commissioner, Supra,* which Petitioner believes to be of sufficient importance to be set forth verbatim herein:

> "... It is apparent that the choice as to the method of reconstruction to be employed lies with the Commissioner, and not the taxpayer, *the only restriction being that the method adopted be reasonable.*" (Italics supplied).

It will be observed that the authority granted to the Commissioner under Section 41, Internal Revenue Code, 1939, is not an absolute, unrestricted power; the method adopted must be *reasonable.*

Respondent argues in support of the Tax Court's findings that the so-called "specific items" of understated income furnished a more accurate guide to the computation of Decedent's income than the net worth method; it attempts to substantiate this position by referring to the existence of a safety deposit box maintained by the Decedent and by claiming that Petitioner's query as to the whereabouts of the sum of $131,000.00 is readily answerable by the fact that the contents of the safety deposit box were not included in the net worth computation; this argument, of course, is not only facetious but disregards and

ignores actual facts; upon the death of the Decedent, the Administrator examined the contents of the safety deposit box and made an accounting to the Probate Court whose records were available to Respondent's agents as well as to Petitioner who examined them in compiling the net worth; no such funds were contained in Decedent's safety deposit box. If, as Respondent represented to the Court below, it stipulated to the net worth only for the purpose of corroborating the testimony of Webb and Goldstein, the use of the Administrator's report was available for such purposes.

Respondent claims that Petitioner obviously overlooks the fact that the net worth technique of computing income is not a method of accounting. How, it is asked, has Petitioner regarded the net worth as a method of accounting in this proceeding? All that Petitioner has done is to adopt the net worth method of determining taxable income rather than accepting the highly questionable testimony of Webb and Goldstein; nowhere, has Petitioner claimed that the net worth method constitutes a recognized method of *accounting*. The cases cited by Respondent in support of his contention, therefore, are of academic interest only and can serve no useful purpose in this controversy.

The Tax Court's determination of deficiencies may be tested by still another approach; in its decision, the Court below increased Decedent's income from the French Cafe and the Southern Wine and Liquor Bar and also reduced the cost of goods sold as to both of these operations; by so doing, a most interesting result is obtained; the following tabulation reflects comparatives of percentages as to *net profit*, compared with those compiled by the Treasury Department of the United States with those resulting from the adjustments effected by the Tax Court:

Year	Treasury Dept. Statistics National Average	Per Tax Court Findings
1942	5.0	24.02
1943	6.63	32.93
1944	5.28	24.35
1945	5.96	19.37
1946	5.98	26.83
1947	4.88	45.00

III

Respondent cites several cases in support of its claim that the findings of the Tax Court, as to fraud, will not be disturbed on appeal if such findings are supported by clear and convincing evidence; Petitioner agrees with this well recognized principle of law but, however, disagrees with the finding that the facts herein are clear and convincing within the meaning of the cases upon which Respondent relies; first of all, the evidence itself, oral testimony, does not, as a matter of law, constitute clear and convincing evidence; to meet that definition, such testimony must be credible and reliable. Petitioner has, it is submitted, unquestionably demonstrated the incredibility and unreliability of the oral testimony upon which the fraud penalty has been predicated. It is equally well recognized that a deficiency, by itself, does not constitute clear and convincing evidence justifying the imposition of the fraud penalty. *Kerbaugh, Henry S.,* 29 B.T.A. 1014; aff'd. 74 Fed. 2d 749, C.A. 1 (1939); *Nicholson* v. *Commissioner,* 32 B.T.A. 977 (1935), aff'd. 90 Fed. 2d 978; *Schultze, William J.,* 18 B.T.A. 444 (1929); *Switzer, L. Glenn,* 20 T.C. 759; *Wiseley* v. *Commissioner,* 185 Fed. 2d 263, reversing 13 T.C. 253.

The alleged falsification of Decedent's records is based upon extremely tenuous explanations of two witnesses, viz. that they were "instructed" to do so; such an explanation is patently self-serving and consequently is of insuffi-

cient weight to constitute clear and convincing evidence within the judicial meaning thereof.

When this proceeding is viewed in its entirety, and painted with a "broad brush", not even a trace of fraud remains.

IV

In its opinion, the Tax Court observed that the issue of the survival of the fraud penalty was raised by Petitioner in its brief but that it had not been raised in the pleadings; the Tax Court, therefore, held that this issue was not properly before it. The Rules of the Tax Court do not provide for the raising of legal arguments in the petition. Rule 6 of the Rules of Practice, Tax Court of the United States.

Under the Rules of the Tax Court, the petition must contain assignments of error which Petitioner alleges to have been committed by the Commissioner in the *determination of the deficiency*; it must also contain a concise statement of facts upon which Petitioner relies in support of the assignment of errors. It is obvious of course, that Decedent was deceased prior to the mailing of the Statutory Notice of Deficiency; the statute of limitations was pleaded and the Petitioner prayed for such further relief as the nature of the case may require; the petition contained allegations as to the date on which Decedent's income tax returns were filed and the petition, itself, was filed in the name of the Administrator of Decedent's Estate; the issue of the survival of the fraud penalty is exclusively a question of law involving the construction and interpretation of legislative enactments. In its discretion, the Tax Court could have taken cognizance of the issue at the time it was presented by the Petitioner in its brief; based on the foregoing facts, the failure of the Tax Court to consider this issue constitutes an abuse of discretion and likewise constitutes reversible error. Furthermore, Respondent, in its

brief, filed with this Court, has presented opposing arguments on this issue; having done so, Respondent has waived its rights and this Court has jurisdiction to review all such matters.

CONCLUSION

For the reasons herein set forth and for those contained in Petitioner's original brief, the decision of the Tax Court should be reversed and the Tax Court should be directed to reach a decision based upon the law and the evidence.

Respectfully submitted,

ELLSWORTH T. SIMPSON
NYLEN, GILMORE & SIMPSON
1029-33 Investment Building
Washington 5, D. C.
Attorneys for Petitioner on Review

Of Counsel:

THOMAS H. WERDEL, Esquire
Bakersfield, California

No. 16823

United States
Court of Appeals
for the Ninth Circuit

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

In Two Volumes

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Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-3-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

ELLSWORTH T. SIMPSON,
1039-33 Investment Bldg.,
Washington 5, D. C.,

For the Petitioner.

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Asst. Atty. General, Tax Division;

LEE A. JACKSON,
Chief, Appellate Section;

RICHARD B. BUHRMAN,
Atty., Appellate Section,
Department of Justice,
Washington 25, D. C.,

For the Respondent.

In the Tax Court of the United States

Docket No. 61480

ESTATE OF WALTER F. RAU, SR., Deceased; RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1956

Mar. 20—Petition received and filed. Taxpayer notified. Fee paid.

Mar. 22—Copy of petition served on General Counsel. Served 3/22/56.

Apr. 17—Answer filed by Respt.

Apr. 17—Request for hearing in Los Angeles, Calif., filed by Respt. 4/18/56, Granted. Served 4/20/56.

May 4—Reply to answer filed by petitioner. Served 5/4/56.

1958

Mar. 13—Notice of trial June 23, 1958, Los Angeles.

June 26-27, 30 & July 1—Trial had before Judge Raum on merits and Pet. oral mot. to hold open for testimony of 1 witness. Granted. No obj. by Resp. Stip. of Facts with Ex. 1-A, Stip. of Facts with "B," Stip. of Facts "C" and trial memo. of Resp. & Petr. filed at trial. Petr. brief due Sept. 2, 1958. Resp. Answer

1958

due Oct. 2, 1958. Petr. Reply due Oct. 22, 1958.

July 14—Trial on further testimony per Petr. oral motion to hold record open. Testimony of Walter Slater. Appearance of T. H. Werdel, Esq., filed.

July 17—Transcript of proceedings of June 26-27, June 30 and July 1-2, 1958, filed.

July 21—Supp. minutes—Judge Raum. Case open to receive supp. stip. of facts. Supp. stip. of Facts—D. filed.

July 25—Transcript of proceedings of July 14, 1958, filed.

Aug. 18—Motion by resp. for leave to file amendment to answer, amendment to answer lodged. Granted 8/29/58.

Aug. 29—Amendment to Answer filed by Resp.

Sept. 2—Orig. Brief for Petr. filed. Served 9/3/58.

Sept. 15—Reply to Amendment to Answer filed by Petr.

Sept. 30—Motion by resp. for extension of time to Dec. 1, 1958, to file brief. Granted 10/1/58.

Nov. 24—Motion by resp. for extension of time to Dec. 31, 1958, to file brief. Granted 11/25/58. Served 11/26/58.

Dec. 29—Motion by resp. for extension of time to Jan. 15, 1959, to file brief. Granted 1/2/59. Served 1/5/59.

1959

Jan. 15—Brief in answer filed by resp. Served 1/19/59.

1959

Jan. 26—Motion by petr. for extension of time to March 6, 1959, to file Reply Brief. Granted 1/28/59. Served 1/29/59.

Feb. 25—Reply Brief filed by petr. Served 2/27/59.

June 8—Memo. Findings of Fact and Opinion filed. J. Raum. Decision under R. 50. Served 6/8/59.

June 18—Motion by petr. for further trial. Denied 6/23/59. Served 6/24/59.

Sept. 10—Agreed Comp. filed.

Sept. 25—Decision entered. Judge Raum. Served 9/29/59.

Dec. 23—Petition for Review by U. S. Ct. of Ap. 9th Cir., with certificate of service thereon, filed by petr.

Dec. 30—Motion by petr. to extend time for preparation of evidence, transmission and delivery of record on review to March 22, 1960.

Dec. 31—Order extending time to Mar. 22, 1960, to file record on rev. and docket pet. for rev. Served 12/31/59.

1960

Jan. 21—Motion for leave to withdraw original exhibits 2D to 7I and substitute photostatic copies therefor, filed by resp. Granted 1/21/60. Served 1/21/60.

Mar. 14—Designation of contents of record on rev., with proof of service thereon, filed by petr.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his Notice of Deficiency dated January 17, 1956, and, as a basis of his proceeding, alleges as follows:

I.

Petitioner is the Administrator With the Will Annexed of the estate of Walter F. Rau, Sr., deceased, with offices in Bakersfield, California. The returns for the periods involved herein were filed with the Collector of Internal Revenue at Los Angeles, California.

II.

The Notice of Deficiency, a copy of which is attached hereto and made a part hereof by reference, was mailed to the petitioner on January 17, 1956.

III.

The taxes in controversy are Federal income taxes and the 50 per cent fraud penalty for each of the years as indicated below:

Year	Deficiency	293 (b) Penalty
1942	$ 6,230.87	$ 3,115.44
1943	37,390.14	25,692.50
1944	32,173.36	17,952.10
1945	45,138.58	22,569.29
1946	10,638.16	5,319.08
1947	17,214.11	8,607.06
Totals	$148,785.22	$83,255.47

IV.

The determination of the income taxes and penalties as set forth in the said Notice of Deficiency, is based upon the following errors:

1. The Commissioner of Internal Revenue erred in proposing deficiencies and penalties for the years 1942, 1943, 1944, 1945, 1946 and 1947.

2. The Commissioner of Internal Revenue erred in determining that petitioner is liable for the 50 per cent fraud penalty for the years 1942, 1943, 1944, 1945, 1946 and 1947.

3. The Commissioner of Internal Revenue erred in determining the net taxable income for each of the years 1942 to 1947, inclusive.

V.

The facts upon which petitioner relies as a basis of his proceeding are as follows:

1. The income tax return for the calendar year 1942 was filed by Walter F. Rau, Sr., deceased, on or before March 15, 1943; the income tax return for the calendar year 1943 was filed by Walter F. Rau, Sr., deceased, on or before March 15, 1944; the income tax return for the calendar year 1944 was filed by Walter F. Rau, Sr., deceased, on or before March 15, 1945; the income tax return for the calendar year 1945 was filed by Walter F. Rau, Sr., deceased, on or before March 15, 1946; the income tax return for the calendar year 1946 was filed by Walter F. Rau, Sr., deceased, on or before March

15, 1947; and the income tax return for the calendar year 1947 was filed by Walter F. Rau, Sr., deceased, on or before March 15, 1948. The Notice of Deficiency was mailed to petitioner on the date of January 17, 1956.

2. The returns filed by Walter F. Rau, Sr., deceased, for each of the years herein involved were not filed with fraudulent intent to evade and defeat payment of income tax.

3. The Statute of Limitations is a bar to the assessment and collection of any tax for the calendar years 1942 to 1947, inclusive. Section 275(a) of the Internal Revenue Code (1939).

4. The deficiencies, as reflected in the Notice of Deficiency, are based upon estimations and approximations for each of the years involved herein.

5. In determining said deficiencies, the Commissioner of Internal Revenue did so by including therein items that do not properly constitute taxable income.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that the Commissioner of Internal Revenue is in error in proposing deficiencies in income taxes for the years 1942 to 1947, inclusive; that the income tax returns filed by Walter F. Rau, Sr., deceased, were not false or fraudulent; that the Statute of Limitations is a bar to the assessment and collection of any tax for the

years in question; and afford such further relief as the nature of the case may require.

/s/ ELLSWORTH T. SIMPSON,
Attorney for Petitioner.

Duly verified.

Notice of Deficiency

1250 Subway Terminal Building
417 South Hill Street
Los Angeles 13, California

January 17, 1956.

Mr. Raymond J. Shorb, Administrator with the Will Annexed of the Estate of Walter F. Rau, Sr.
c/o Burum and Young,
506 Haberfelde Building,
Bakersfield, California.

Dear Mr. Shorb:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1942, to December 31, 1947, inclusive, discloses deficiencies in tax aggregating $148,785.22 and penalties aggregating $83,255.47, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address,

Washington 4, D. C., for a redetermination of the deficiencies and penalties. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form in duplicate, and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 South Hill Street, Los Angeles 13, California. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiencies and penalties, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earliest.

Very truly yours,

RUSSELL C. HARRINGTON,
Commissioner of Internal
Revenue.

By /s/ H. L. DUCKER,
Associate Chief, Appellate
Division.

Enclosures:
Statement
Form 160
Agreement Form

Ap:LA:AA-EWM
90-D:BVH

Statement

Estate of Walter F. Rau, Sr., Deceased.
Mr. Raymond J. Shorb, Executor.
c/o Barum and Young,
506 Haberfelde Building,
Bakersfield, California.

Tax Liability for the Taxable Years Ended December 31, 1942, December 31, 1943, December 31, 1944, December 31, 1945, December 31, 1946 and December 31, 1947.

Income Tax

Year	Deficiency	293 (b) Penalty
1942	$ 6,230.87	$ 3,115.44
1943	37,390.14	25,692.50
1944	32,173.36	17,952.10
1945	45,138.58	22,569.29
1946	10,638.16	5,319.08
1947	17,214.11	8,607.06
Totals	$148,785.22	$83,255.47

In making this determination of your income tax liabilities and penalties, careful consideration has been given to the report of examination dated October 4, 1949, to your protest dated January 20, 1954, and to the statements made at the conference held on April 11, 1955.

The 50% penalty is asserted for each of the taxable years 1942 to 1947 in accordance with the provisions of Section 293 (b) of the Internal Revenue Code of 1939.

A copy of the letter and a copy of the statement have been mailed to your representative, Mr. Ellsworth T. Simpson, 1000 Vermont Avenue, N.W., Washington, D. C., in accordance with the authority contained in the power of attorney executed by you.

It has been determined that you failed to report income in your Federal personal income tax returns for the years 1942 to 1947, inclusive, from the French Cafe and the Southern Wine and Liquor Store in the respective amounts of $56,180.00 and $94,325.00.

The above increases in income have been allocated as shown below:

Year	French Cafe	Southern Wine and Liquor Store
1942	$13,010.00	$16,925.00
1943	13,010.00	16,925.00
1944	13,020.00	16,950.00
1945	13,010.00	16,925.00
1946	4,130.00	16,925.00
1947	—0—	9,675.00
Totals	$56,180.00	$94,325.00

Year 1942

Adjustments to Net Income

Net income as disclosed by the return		$ 4,121.92
Unallowable deductions and additional income:		
(a) Adjustment of business income		16,185.82
Total		$20,307.74
Nontaxable income and additional deductions:		
(b) Adjustment of deduction for contributions	$112.50	
(c) Adjustment of deduction for taxes on residential property	8.34	120.84
Net income as revised		$20,186.90

Explanation of Adjustments

(a) Your net income is increased $16,185.82, representing adjustment of business income computed as follows:

Increase in business income on the basis of schedules previously furnished you	$32,371.63
Taxpayer's community one-half	$16,185.82

(b) Your net income is decreased $112.50, representing your community share of an allowable deduction of $225.00 for contributions which was disallowed as a business expense deduction.

(c) Your net income is decreased $8.34, representing your community share of an allowable deduction of $16.69 for taxes on residential property which was disallowed as a business expense.

Computation of Tax

Net income	$20,186.90
Less: Personal exemption	600.00
Surtax net income	$19,586.90
Less:	
Earned income credit (10% or 20% of $20,186.90)	403.74
Income subject to normal tax	$19,183.16
Normal tax on $19,183.16 at 6%	1,150.99
Surtax on $19,586.90	5,769.97
Total income tax	$ 6,920.96
Less: Income tax paid at source	172.53
Correct income tax liability	$ 6,748.43
Income tax assessed on the original return, Account No. B 114203, 6th California District	517.56
Deficiency in income tax	$ 6,230.87
50% Fraud Penalty	$ 3,115.44

Year 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by the return	$17,859.24	$17,859.24
Unallowable deductions and additional income:		
(a) Adjustment of business income	69,234.50	69,234.50
Totals	$87,093.74	$87,093.74
Nontaxable income and additional deductions:		
(b) Adjustment of deductions for taxes as nonbusiness property and State income tax	62.35	None
Net income as revised	$87,031.39	$87,093.74

Explanation of Adjustments

(a) Your income tax and victory tax net income is increased $69,234.50, representing adjustment of business income on the basis of schedules previously furnished you.

(b) Your net income is decreased $62.35, representing allowable deductions for taxes on nonbusiness property and State income tax which were disallowed as business expense deductions.

Computation of Income and Victory Tax

Income tax net income		$87,031.39
Less: Personal exemption		500.00
Surtax net income		$86,531.39
Less: Earned income credit		1,400.00
Normal tax net income		$85,131.39
Normal tax on $85,131.39 at 6%		$ 5,107.88
Surtax on $86,531.39		48,838.54
Total income tax		$53,946.42
Victory tax net income	$87,093.74	
Less: Specific exemption	624.00	
Income subject to victory tax	$86,469.74	
Victory tax before credit (5% of $86,469.74)	4,323.49	
Less: Victory tax credit (25% of $4,323.49)	1,080.87	
Net victory tax		3,242.62
Income tax and victory tax		$57,189.04
Income and victory tax liability		$57,189.04
Tax assessed:		
Tax liability shown by line 16 of the 1943 return	$ 5,804.03	
Additional assessment, Account No. 511064, February, 1947, List	13,994.87	19,798.90
Deficiency in income and victory tax		$37,390.14

50% Fraud penalty (50% of $51,385.01)*		$25,692.50
*Income and victory tax liability	$57,189.04	
Tax liability shown by line 16 of the 1943 return	5,804.03	
Balance	$51,385.01	

Year 1944

Adjustment to Net Income

Net income as disclosed by the return		$35,493.94
Unallowable deductions and additional income:		
(a) Adjustment of business income		45,856.70
Net income as revised		$81,350.64

Explanation of Adjustment

(a) Your net income is increased $45,856.70, representing adjustment of business income on the basis of schedules previously furnished you.

Computation of Tax

Net income		$81,350.64
Less: Surtax exemption		500.00
Surtax net income		$80,850.64
Net income		81,350.64
Less: Normal tax exemption		500.00
Normal tax net income		$80,850.64
Normal tax on $80,850.64 at 3%		2,425.52
Surtax on $80,850.64		50,934.54
Total income tax		$53,360.06
Correct income tax liability		$53,360.06
Less: Income tax liability disclosed by the original return, Account No. 3061471, 6th California District	$17,455.87	
Additional assessment, Account No. 511065, February, 1947, List	3,730.83	21,186.70
Deficiency in income tax		$32,173.36
50% fraud penalty (50% of $35,904.19)*		$17,952.10

*Income tax liability		$53,360.06
Income tax liability disclosed by the return		17,455.87
Balance		$35,904.19

Year 1945

Adjustments to Net Income

Net income as disclosed by the return		$44,959.76
Unallowable deductions and additional income:		
(a) Adjustment of business income	$55,160.42	
(b) Elimination of standard deduction	500.00	55,660.42
Total		$100,620.18
Nontaxable income and additional deductions:		
(c) Adjustment of deduction for contributions	200.00	
(d) Adjustment of deduction for State income tax	1,049.73	1,249.73
Net income as revised		$99,370.45

Explanation of Adjustments

(a) Your net income is increased $55,160.42, representing adjustment of business income on the basis of schedules previously furnished you.

(b) Your net income is increased $500.00, representing disallowance of standard deduction in view of the fact itemized deductions are being allowed.

(c) Your net income is decreased $200.00, representing an allowable deduction for contributions which was disallowed as a business expense deduction.

(d) Your net income is decreased $1,049.73, representing an allowable deduction for State income tax which was disallowed as a business expense deduction.

Computation of Tax

Net income	$99,370.45
Less: Surtax exemption	500.00
Surtax net income	$98,870.45
Net income	$99,370.45
Less: Normal tax exemption	500.00
Normal tax net income	$98,870.45
Normal tax on $98,870.45 at 3%	2,966.11
Surtax on $98,870.45	66,337.29
Total income tax	$69,303.40
Correct income tax liability	$69,303.40
Income tax liability disclosed by the original return, Account No. 3049966, 6th California District	24,164.82
Deficiency in income tax	$45,138.58
50% Fraud penalty	$22,569.29

Year 1946

Adjustments to Net Income

Net income as disclosed by the return		$89,060.84
Unallowable deductions and additional income:		
(a) Adjustment of business income	$13,980.24	
(b) Elimination of standard deduction	500.00	14,480.24
Total		$103,541.08
Nontaxable income and additional deductions:		
(c) Adjustment of deduction for State income tax		1,592.57
Net income as revised		$101,948.51

Explanation of Adjustments

(a) Your net income is increased $13,980.24, representing adjustment of business income on the basis of schedules previously furnished you.

(b) Your net income is increased $500.00, representing disallowance of standard deduction in view of fact an itemized deduction is being allowed.

(c) Your net income is decreased $1,592.57, representing an allowable deduction for State income tax which was disallowed as a business expense deduction.

Computation of Tax

Net income	$101,948.51
Less: Exemption	500.00
Income subject to tentative tax	$101,448.51
Tax on $101,448.51	$ 68,609.17
Less: 5% of $68,609.17	3,430.46
Combined normal tax and surtax	$ 65,178.71
Correct income tax liability	$ 65,178.71
Income tax liability disclosed by the original return, Account No. 3200992, 6th California District	54,540.55
Deficiency in income tax	$ 10,638.16
50% Fraud penalty	5,319.08

Year 1947

Adjustments to Net Income

Net income as disclosed by the return		$27,371.48
Unallowable deductions and additional income:		
(a) Adjustment of business income	$29,603.24	
(b) Disallowance of deduction for medical expense	424.69	30,027.93
Total		$57,399.41

Nontaxable income and additional deductions:		
(c) Adjustment of loss on sale of depreciable assets used in trade or business	$ 779.02	
(d) Adjustment of deducion for interest expense	2,679.82	3,458.84
Net income as revised		$53,940.57

Explanation of Adjustments

(a) Your net income is increased $29,603.24, representing adjustment of business income on the basis of schedules previously furnished you.

(b) Your net income is increased $424.69, representing adjustment of deduction for medical expense computed as follows:

Total medical expenses	$ 2,046.46	
Total adjusted gross income as shown by the return		$32,435.39
Add: Adjustment to business income	$29,603.24	
Less: Additional loss on sale of depreciable assets	779.02	28,824.22
Total adjusted gross income as revised		$61,259.61
5% of adjusted gross income of $61,259.61		3,062.98
Medical expenses		2,046.46
Allowable medical expense deduction		None
Medical expense deduction claimed on the return		424.69
Increase in net income		$ 424.69

(c) Your net income is decreased $779.02, representing adjustment in loss on sale of depreciable assets as shown in Exhibit A.

(d) Your net income is decreased $2,679.82, representing an allowable deduction for interest paid on delinquent income tax.

Computation of Tax

Net income	$53,940.57
Less: Exemption	500.00
Income subject to tentative tax	$53,440.57
Tax on $53,440.57	$29,400.43
Less: 5% of $29,400.43	1,470.02
Combined normal tax and surtax	$27,930.41
Correct income tax liability	$27,930.41
Income tax liability disclosed by the return, Account No. 9110055, 6th California District	10,716.30
Deficiency in income tax	$17,214.11
50% Fraud penalty	$ 8,607.06

Statement

Exhibit A

Computation of Gains and Losses on Sales of Depreciable Assets Used in Trade or Business

Kind of Property	Date Acquired	Date Sold	Gross Sales Price	Cost	Expense of Sale	Depreciation Allowed	Gain or Loss
Frame Building, Venice, California	1932	11/18/47	$13,500.00	$ 8,332.30	$ 741.95	$ 5,658.50	$10,084.25
Taft Hotel, Taft, California	6/1/1946	3/31/47	53,793.92	70,000.00	—0—	1,499.94	(14,706.14)
Furniture and Fixtures, Southern Hotel	1937	8/10/47	2,869.90	8,600.00	1,027.03	8,600.00	1,842.87
Totals			$70,163.82	$86,932.30	$1,768.98	$15,758.44	($2,779.02)

Net loss on sale of depreciable assets used in trade or business becomes ordinary loss	$2,779.02
Capital loss on sale of depreciable assets used in trade or business deducted on the return	2,000.00
Additional allowable loss	$ 779.02

Received and filed March 20, 1956, T. C. U. S.
Served March 22, 1956.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above petitioner, admits, denies and alleges as follows:

I. to III.
(Inclusive)

Admits the allegations contained in paragraphs I to III, inclusive, of the petition.

IV.

1 to 3, inclusive. Denies that the respondent erred as alleged in subparagraphs 1 to 3, inclusive, of paragraph IV of the petition.

V.

1. Admits the allegations contained in subparagraph 1 of paragraph V of the petition.

2 to 5, inclusive. Denies the allegations contained in subparagraphs 2 to 5, inclusive, of paragraph V of the petition.

VI.

Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

For further answer to the petition, respondent alleges:

VII.

That during the taxable years 1942 to 1947, both inclusive, petitioner's decedent was engaged in various businesses and income producing activities which included the ownership and management of hotels, cafes, and liquor stores, and that petitioner's decedent received income from these and other sources in excess of the amounts reported by him on his Federal individual income tax returns filed for said years.

VIII.

That for the taxable years 1942 to 1947, both inclusive, the following schedule shows petitioner's decedent's true income tax liability, the amount reported as income tax liability on the return, the deficiency and the addition to the tax under section 293(b) of the Internal Revenue Code of 1939:

Taxable Year	True Liability	Liability Reported on Return	Deficiency	Addition to Tax 293 (b)
1942	$ 6,748.43	$ —0—	$ 6,230.87	$ 3,115.44
1943	57,189.04	(1) 19,560.45	37,390.14	(3) 25,692.50
1944	53,360.06	(2) 21,186.70	32,173.36	(3) 17,952.10
1945	69,303.40	24,164.82	45,138.58	22,569.29
1946	65,178.71	54,540.55	10,638.16	5,319.08
1947	27,930.41	10,716.30	17,214.11	8,607.06

(1) Tax per original return was $5,804.03 which was increased to $19,560.45 by reason of a prior assessment by respondent.

(2) Tax per original return was $17,455.87 which was increased to $21,186.70 by reason of a prior assessment by respondent.

(3) Addition to tax based on liability as originally reported.

IX.

That the petitioner's decedent well knew that for each of the taxable years 1942 to 1947, both inclusive, he had received incomes in excess of the amounts reported by him and incurred income tax liabilities as hereinabove set forth and by reason thereof, the returns as filed by the petitioner's decedent for each of the said taxable years is due to fraud with intent to evade tax; and the proceeding and assessment against the petitioner for each of said taxable years are not barred by the statute of limitations; and for each of said taxable years there is due and owing under section 293(b), Internal Revenue Code, as an addition to the tax, fifty per cent of the deficiency for each of said years.

X.

That for the taxable years 1945 to 1947, both inclusive, there were validly executed by and for petitioner's decedent waivers, Form No. 872, which extended the time for assessment and collection of his Federal individual income taxes to any time on or before June 30, 1956. That the statutory notice of deficiencies herein was mailed on January 17, 1956.

Wherefore, it is prayed

1. That petitioner's appeal be denied;

2. That the deficiencies in tax as determined by the respondent and as set forth in the statutory notice of deficiencies be in all respects approved;

3. That the additions to the tax for the taxable years involved as determined by respondent and as set forth in the statutory notice of deficiencies be in all respects approved;

4. That this Honorable Court determine that the assessment of the deficiencies is not barred by the statute of limitations; and

5. That the deficiencies involved in this proceeding are due to fraud with intent to evade tax.

/s/ JOHN POTTS BARNES, REM,
Chief Counsel,
Internal Revenue Service.

Of Counsel:

MELVIN L. SEARS,
Regional Counsel.
E. C. CROUTER,
Assistant Regional Counsel.
R. E. MAIDEN, JR.,
Special Assistant to the Regional Counsel.
RICHARD W. JANES,
Attorney, Internal Revenue Service.

Filed April 17, 1956, T. C. U. S.

Served April 20, 1956.

Entered April 23, 1956.

[Title of Tax Court and Cause.]

REPLY

Comes now the Petitioner's Decedent, by his attorney, Ellsworth T. Simpson, and for reply to the affirmative allegations set forth in the Answer filed by the Respondent.

VII.

Admits that during the taxable years 1942 to 1947, both inclusive, Petitioner's Decedent was engaged in various businesses and income producing activities which included the ownership and management of hotels, cafes and liquor stores, but denies the remaining allegations of Paragraph VII of the Answer.

VIII.

Admits the amount reported by Petitioner's Decedent as reflected in the schedule set forth in Paragraph VIII, but denies the other amounts appearing in said schedule.

IX.

Denies allegations contained in Paragraph IX of the Answer.

X.

Admits allegations contained in Paragraph X of the Answer.

XI.

Denies that any of the income tax returns filed by Petitioner's Decedent for the years 1942 to 1947, inclusive, were filed with fraudulent intent to evade and defeat payment of his income taxes.

Respectfully submitted,

/s/ ELLSWORTH T. SIMPSON,
Attorney for Petitioner's
Decedent.

Served May 4, 1956.

Received and filed May 4, 1956, T. C. U. S.

Entered May 4, 1956.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated, for the purpose of this case, that the following statements may be accepted as facts, subject to the right of either party to object to the admission of such facts in evidence on the grounds of materiality and relevancy; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated.

1. This proceeding involves liabilities of the Estate of Walter F. Rau, Sr., deceased, for income taxes and additions to tax under Section 293(b), Internal Revenue Code of 1939, for the taxable years 1942 to 1947, inclusive.

2. Mary Agnes Rau, wife of the decedent, died on December 27, 1942, and the decedent never remarried.

3. Walter F. Rau, Sr., had no dependents for any of the years in question.

4. On May 12, 1952, Walter F. Rau, Sr., was declared incompetent but, on May 13, 1952, the Superior Court of the State of California in and for the County of Kern, issued an order appointing Betty Dorsey the guardian of the person of Walter F. Rau, Sr., and pursuant to the same order appointed the Bank of America National Trust and Savings Association as guardian of the Estate of Walter F. Rau, Sr.

5. At the date of his death on January 4, 1953, Walter F. Rau, Sr. was approximately 78 years of age.

6. On January 27, 1953, the Superior Court of the State of California in and for the County of Kern, entered an order admitting the will of Walter F. Rau, Sr. to probate. By virtue of this same order, the Bank of America National Trust and Savings Association was appointed Executor of the Estate of Walter F. Rau, Sr.

7. Subsequent to its appointment as executor, the Bank of America National Trust and Savings Association withdrew as executor and on the 9th day of March, 1955, Raymond J. Shorb was appointed as administrator with the will annexed in accordance with an order issued on that date by the Superior Court of the State of California in and for the County of Kern.

8. Commencing in 1932, and continuing to August 7, 1947, Walter F. Rau, Sr. operated a business

known as the Southern Hotel in Bakersfield, California. This business was operated under a lease and was conducted by Walter F. Rau, Sr., as a sole proprietorship.

9. Walter F. Rau, Sr. owned and operated a business known as the French Cafe, 1901 Chester Avenue, Bakersfield, California, located in the above-named Southern Hotel, from 1934, to May 6, 1946, at which time he formed a partnership with one Phil Bender. Mr. Rau, Sr. had a two-thirds interest in the partnership which operated under the name of the French Cafe. This partnership was terminated on August 16, 1947.

10. On June 1, 1947, a partnership consisting of Walter F. Rau, Sr., Phil Bender and Robert R. Webb was formed for the purpose of conducting a business known as the French Cafe located at 1800 Chester Avenue, Bakersfield, California. This partnership continued to operate throughout the remainder of the year 1947.

11. From 1934 to August 12, 1947, Walter F. Rau, Sr. owned and operated a business known as the Southern Wine and Liquor Store, located in the above-named Southern Hotel in Bakersfield, California, as a sole proprietorship.

12. Beginning in June, 1944, and continuing throughout the years in question, Walter F. Rau, Sr. owned and operated the Edmund Hotel in Venice, California.

13. From 1944 to 1947, inclusive, Walter F. Rau, Sr. owned and operated the Sea Spray Hotel in Venice, California.

14. In June, 1946, Walter F. Rau, Sr. purchased the Taft Hotel in Taft, California. He owned and operated this hotel together with its restaurant and bar from June, 1946, throughout the remainder of the period here involved.

15. In the year 1947, W. F. Rau, Sr. paid $2,238.40 to the Jefferson Standard Life Insurance Company.

16. Attached as Exhibit 1-A is a schedule setting forth the assets and liabilities of Walter F. Rau, Sr. on the dates as indicated. Exhibit 1-A also sets forth certain expenditures of Walter F. Rau, Sr. incurred during each of the years as indicated.

/s/ E. T. SIMPSON,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Filed at trial June 26, 1958.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS—B

It is hereby stipulated, for the purpose of this case, that the following statements may be accepted

as facts, subject to the right of either party to object to the admission of such facts in evidence on the grounds of materiality and relevancy; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated.

Attached is a summary of the daily slips as shown in exhibits 20-24, inclusive, for the French Cafe, for the years as indicated. Robert Webb has testified, and would testify, that the column identified as "additions" constitutes amounts which increased the daily receipts as indicated. He has also testified, and would testify, that he drew checks to cash in like amounts as shown in the "additions" column and entered notations on the check stubs that such checks were for supplies.

/s/ E. T. SIMPSON,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

W. F. Rau, Sr., Sales and Expense Sheet—1943
French Cafe

Date	Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Sept. 20....	384.17	.....	100.29	33.35	10.00	307.23
21....	517.34	.....	152.96	61.30	10.00	415.68
22....	416.37	.....	98.24	25.30	10.00	333.43
23....	406.31	.....	161.96	71.30	10.00	305.65
24....	445.46	.....	139.36	52.10	10.00	348.20
25....	637.48	.....	153.58	27.20	110.00	401.10

Date	Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
27....	445.32	.....	112.54	32.15	10.00	354.93
29....	463.20	.....	144.79	33.50	10.00	341.91
Oct. 5....	589.37	.....	115.31	38.40	110.00	402.46
8....	492.94	8.35	126.18	39.50	10.00	387.91
9....	762.89	7.50	198.31	.....	110.00	447.08
12....	535.65	5.40	214.70	95.35	10.00	400.90
14....	403.60	7.60	109.85	38.52	10.00	314.67
15....	407.64	2.90	114.50	52.20	10.00	332.44
16....	641.29	5.15	173.07	48.30	110.00	401.37
Nov. 1....	468.56	4.00	142.77	62.20	10.00	373.99
17....	371.12	3.50	96.44	8.65	10.00	269.83
18....	341.70	2.85	77.07	.....	10.00	251.78
19....	361.51	.....	98.04	.....	.....	263.47
20....	625.27	1.80	153.22	.....	110.00	360.25
22....	402.32	2.75	170.18	.....	10.00	219.39
23....	475.02	2.95	80.93	.....	10.00	381.14
24....	398.07	1.50	175.52	.....	.....	521.05
25....	592.24	1.55	31.60	.....	.....	559.09
26....	423.51	1.80	150.97	.....	.....	270.74
27....	661.30	.25	87.43	.....	.....	573.62
Dec. 7....	525.97	5.70	162.24	26.75	10.00	374.78
9....	456.01	1.70	105.00	32.20	10.00	371.51
10....	558.07	2.00	77.53	.....	10.00	468.54
11....	615.29	2.35	119.81	.....	10.00	483.13
12....	533.05	1.15	.....	.....	10.00	521.90
13....	439.25	1.50	205.43	81.40	10.00	303.72
15....	357.76	4.45	86.68	46.40	10.00	303.03
16....	353.37	1.90	88.44	47.20	10.00	300.23
18....	617.84	2.45	110.59	.....	10.00	494.80
19....	459.70	3.00	.....	.....	10.00	446.70
21....	432.27	3.80	109.92	34.25	10.00	342.80
22....	395.16	3.60	92.87	31.45	10.00	320.14
23....	497.87	2.40	142.16	52.30	10.00	395.61
24....	616.71	2.75	220.73	30.50	10.00	413.73
28....	345.02	4.60	72.36	42.10	10.00	300.16
29....	316.62	2.85	187.52	125.40	10.00	241.65
30....	304.28	2.10	109.46	75.50	10.00	258.22
31....	578.44	1.95	212.09	.....	10.00	354.40
	21,072.33	110.10	5,482.64	2,204.77	890.00	15,934.36

W. F. Rau, Sr., 1944 Sales and Expense Sheet—1944
French Cafe

Date		Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Jan.	2....	552.11	2.55	32.57	.....	160.00	356.99
	5....	360.14	1.60	124.04	62.30	27.68	269.12
	6....	419.72	1.10	61.45	2.45	10.00	349.62
	8....	480.32	1.65	133.81	3.92	10.00	338.78
	18....	413.11	2.95	150.91	51.79	10.00	301.04
	26....	314.17	1.40	106.09	.82	.....	207.50
	27....	336.38	.....	93.75	43.49	10.00	276.12
	28....	291.80	.70	105.40	44.35	10.00	220.05
	29....	468.29	2.45	95.66	.61	10.00	360.79
	31....	351.44	1.90	73.23	23.50	10.92	288.89
Feb.	1....	446.12	3.85	162.58	31.10	10.17	300.62
	3....	474.58	2.15	64.96	.....	10.78	396.69
	5....	583.17	4.65	133.08	.....	110.57	334.87
	6....	629.82	4.65	.....	.45	210.00	415.62
	7....	453.15	2.20	193.22	63.48	10.00	311.21
	8....	423.72	1.20	155.64	79.01	14.00	331.89
	10....	344.62	1.35	111.15	52.25	10.12	274.25
	11....	369.85	1.80	60.19	18.14	10.00	316.00
	13....	613.41	.95	.....	.59	210.00	403.05
	14....	380.51	1.05	64.77	21.40	21.09	315.00
	15....	362.59	.....	152.90	62.83	11.50	261.02
	17....	316.54	.....	63.11	20.09	10.00	263.52
	18....	430.87	.55	114.09	2.50	15.25	303.48
	19....	667.61	.80	133.05	1.07	210.00	324.83
	20....	608.43	.10	9.12	.....	213.00	386.21
	21....	390.98	.45	119.09	42.74	10.00	304.18
	22....	424.35	.....	59.40	.19	10.00	355.14
	23....	275.99	.40	100.96	63.20	12.81	225.02
	25....	404.15	1.25	113.58	21.30	10.00	300.62
	27....	639.93	.....	30.00	.....	211.57	398.36
Mar.	6....	417.87	.....	152.48	51.46	10.00	306.85
	10....	426.56	4.72	164.93	73.46	100.00	320.37
	11....	675.45	6.90	163.08	.....	110.47	395.00
	12....	607.19	5.60	6.00	4.46	210.00	390.05
	13....	392.02	6.22	161.40	76.60	10.00	291.00
	14....	550.31	1.73	143.61	.26	10.00	395.23
	16....	428.76	4.08	68.89	.82	10.00	346.61
	17....	419.80	1.30	135.78	47.62	10.00	320.34

Date	Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
18....	529.11	5.13	106.56	.....	110.65	306.77
19....	604.43	6.40	13.05	1.67	210.00	376.65
20....	419.61	3.90	254.41	135.74	10.00	287.04
21....	487.99	3.05	109.30	.....	10.66	364.98
24....	438.30	.....	104.12	.....	10.04	324.14
25....	683.13	.....	106.86	.18	.....	576.45
26....	591.51	.....	48.44	.....	161.17	381.90
27....	377.65	.62	177.90	75.28	10.00	264.41
28....	471.87	.62	145.77	.....	10.79	314.69
29....	321.44	.62	151.20	83.25	10.79	242.08
30....	332.54	.....	121.01	52.50	10.00	254.04
Apr. 8....	776.55	.....	182.43	.....	166.85	427.27
9....	763.92	.....	59.87	1.37	210.00	495.42
10....	411.29	.....	278.70	140.30	10.88	262.01
12....	468.85	.....	89.74	.....	10.76	368.35
13....	416.88	.....	138.20	26.07	10.00	294.75
15....	634.48	.....	116.47	.26	160.00	358.27
16....	662.59	1.00	48.68	.27	210.00	403.18
17....	369.42	.....	196.36	90.10	10.11	253.05
18....	518.74	.....	97.84	.....	10.41	410.49
19....	370.61	.....	190.38	95.25	10.22	265.26
23....	593.35	.....	121.12	.27	110.00	362.50
24....	417.33	.....	184.94	78.25	10.08	300.56
25....	468.55	.....	131.34	.57	10.00	327.78
28....	356.86	.....	129.60	35.74	10.00	253.00
30....	611.88	.....	70.51	.01	160.00	381.38
May 1....	421.08	.....	208.41	81.60	10.23	284.04
6....	724.39	.....	105.15	.06	210.00	409.30
8....	388.98	.....	114.79	21.81	10.00	286.00
9....	518.57	.....	143.73	.....	10.14	364.70
10....	396.82	.....	82.80	.....	10.68	303.34
11....	401.34	.....	52.57	.09	10.00	338.86
29....	408.85	.....	174.79	81.55	10.00	305.61
30....	578.18	.....	48.81	.09	110.00	419.46
31....	503.80	.....	121.65	.....	12.50	369.65
June 1....	405.07	.....	87.95	1.44	10.00	308.56
July 22....	536.17	.....	106.51	.....	10.62	419.04
23....	664.35	.....	76.61	.25	10.00	577.99
Aug. 19....	681.19	.....	60.44	.93	160.00	461.68
	36,873.50	95.59	8,572.98	1,973.16	4,217.51	25,960.58

W. F. Rau, Sr., Sale and Expense Sheet—1945
French Cafe

Date		Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Aug.	1	364.82	.....	123.83	62.10	10.00	293.09
	2	322.25	.....	69.74	.....	10.00	242.51
	3	321.65	.....	96.44	60.50	10.00	275.71
	4	411.75	.....	111.54	.62	10.00	290.83
	5	491.54	.....	12.38	.....	110.00	369.16
	7	401.23	.....	105.67	.....	10.00	285.56
	8	258.95	.....	80.09	53.10	10.00	221.96
	9	274.13	.....	87.94	60.15	10.00	236.34
	10	354.78	.....	98.82	26.25	10.00	272.21
	11	449.11	.....	136.82	.34	10.00	302.63
	14	312.26	.....	105.81	.....	10.00	196.45
	16	483.54	.....	86.55	.....	10.00	386.99
	17	372.16	.....	130.65	49.20	10.00	280.71
	18	481.00	.....	108.68	.....	10.00	362.32
	19	477.68	.....	28.59	.....	10.00	439.09
	21	390.98	.....	176.41	96.40	10.00	300.97
	22	350.00	.....	162.32	100.10	10.00	277.78
	23	330.97	.....	69.44	.....	10.00	251.53
	24	302.75	.....	71.84	50.20	10.00	271.11
	25	428.19	.....	154.72	3.47	10.00	266.94
	26	519.24	.....	23.95	.....	110.00	385.29
	28	469.96	.....	179.19	51.50	10.00	332.27
	29	408.83	.....	77.52	.....	10.00	321.31
	30	379.52	.....	177.20	105.15	10.00	297.47
	31	458.96	.....	125.32	.....	10.00	323.64
Sept.	1	691.72	.....	149.93	.....	110.00	431.79
	2	666.43	.....	9.60	.....	210.00	446.83
	4	463.24	.....	340.77	190.25	10.00	302.72
	5	381.49	.....	213.56	120.50	10.00	278.43
	6	342.79	.....	135.56	98.50	10.00	295.73
	7	324.63	.....	101.49	65.20	10.00	278.34
	8	466.23	.....	118.92	.96	10.00	338.27
	9	471.58	.....	5.00	.....	110.00	356.58
	11	403.50	.....	136.06	.....	10.00	257.44
	12	434.22	.....	80.61	.....	10.00	343.61
	13	407.49	.....	118.17	31.50	10.00	310.82
	14	426.02	.....	80.96	.....	10.00	335.06

Date	Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
15....	549.14	.....	76.47	.....	110.00	362.67
16....	539.42	.....	14.85	.....	160.00	364.57
18....	417.42	.....	230.87	130.50	10.00	307.05
19....	408.27	.....	46.20	.....	10.00	352.07
21....	476.91	.....	97.65	.....	10.00	369.26
22....	560.27	.....	115.63	.43	110.00	335.07
23....	572.91	.....	10.25	.....	160.00	402.66
25....	427.69	.....	121.70	.41	10.00	296.40
27....	357.57	.....	74.74	.....	10.00	272.83
28....	367.00	.....	65.84	.....	10.00	291.16
29....	463.99	.....	91.18	.....	10.00	362.81
30....	432.43	.....	17.25	.....	10.00	405.18
Oct. 2....	440.34	.....	140.23	.....	10.00	290.11
3....	360.41	.....	96.09	47.20	10.00	301.52
5....	382.17	.....	148.02	75.10	10.00	299.25
6....	473.42	.....	94.66	.38	10.00	369.14
13....	493.99	.....	130.39	.....	10.00	353.60
16....	475.50	.....	91.84	.....	.....	383.66
17....	452.48	.....	98.34	.....	.....	354.14
18....	431.13	.....	88.70	.....	.....	342.43
19....	415.04	.....	128.40	30.30	.....	316.94
20....	519.26	.....	140.45	.....	.....	378.81
24....	522.49	.....	186.57	.....	.....	335.92
25....	435.49	.....	150.11	2.12	.....	287.50
27....	507.89	.....	122.00	.....	.42	385.47
28....	544.47	.....	.....	.....	.....	544.47
30....	663.07	.....	123.86	.35	.....	539.56
Nov. 2....	475.92	.....	148.78	.....	.....	327.14
10....	627.92	.....	102.90	.....	.....	525.02
13....	591.58	.....	180.78	.....	.....	410.80
18....	675.73	.....	49.50	.....	.....	626.23
20....	480.59	.....	134.36	.....	.....	346.23
21....	575.76	.....	186.22	.....	.....	389.54
24....	553.31	.....	143.91	.....	.06	409.34
22....	680.05	.....	10.70	.....	.....	669.35
25....	671.55	.....	23.50	.....	.....	648.05
26....	530.05	.....	125.77	.....	.....	404.28
28....	449.62	.....	144.31	26.26	.....	331.57
30....	519.89	.....	176.37	.61	.....	344.13

Date		Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Dec.	1....	667.76	.....	156.90	.07	.....	510.93
	2....	552.91	.....	53.89	.....	.....	499.02
	3....	485.18	.....	128.64	.....	.....	356.54
	4....	538.91	.....	175.73	.....	.....	363.18
	5....	470.02	.....	97.62	.....	.....	372.40
	6....	520.46	.....	104.79	.....	.....	415.67
	7....	502.30	.....	104.33	.....	.....	397.97
	8....	618.18	.....	86.57	.....	.....	531.61
	9....	593.80	.....	45.68	.....	.....	548.12
	13....	451.22	.....	99.26	.....	.....	351.96
	24....	694.21	.....	129.74	.....	150.00	414.47
	26....	437.39	.....	137.50	46.50	.....	346.39
	27....	490.31	.....	123.44	.....	.....	366.87
	29....	521.21	.....	118.78	.....	.....	402.43
	30....	611.14	.....	64.85	.....	.....	546.29
	31....	690.93	.....	116.66	.....	3.06	571.21
Total	.....	43,663.66	.....	9,965.86	1,586.22	1,793.54	33,490.12

W. F. Rau, Sr., Sales and Expense Sheet—1946
French Cafe

Date		Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Jan.	1....	780.87	.....	54.93	.68	.....	726.62
	2....	526.78	.....	141.48	.....	.....	385.30
	5....	562.64	.....	89.69	.....	.....	472.95
	6....	556.28	.....	42.89	.....	.....	513.39
	7....	490.86	.....	142.26	.....	.....	348.60
	8....	504.95	.....	115.45	.....	.....	389.50
	9....	468.33	.....	127.82	.....	.....	340.51
	10....	489.79	.....	124.21	.....	.....	365.58
	12....	490.97	.....	107.40	.....	.....	383.57
	13....	495.42	.....	24.98	.....	.....	470.54
	14....	446.20	.....	111.09	.....	.....	335.11
	15....	537.20	.....	61.01	.....	.....	476.19
	16....	426.56	.....	89.65	.....	.....	336.91
	28....	388.11	.....	82.42	18.60	.....	324.29
	29....	505.82	.....	98.07	.....	.....	407.75
	30....	377.57	.....	62.27	.....	.....	315.30
	31....	420.01	.....	60.63	.....	.....	359.38

Date	Receipts	Meal Tickets	Cash Pd. Outs	Additions	Subtractions	Total
Feb. 17....	546.14	.....	53.43	.....	100.00	392.71
18....	374.07	.....	74.50	11.75	.....	311.32
19....	415.71	.....	94.15	.....	.....	321.56
20....	376.43	.....	63.96	.....	.....	312.47
21....	417.25	.....	57.50	.....	.....	359.75
22....	447.27	.....	88.28	.....	.....	358.99
23....	507.92	.....	62.20	.....	100.00	345.48
					Cash shortage .24	
24....	501.29	.....	22.40	.....	100.00	378.89
25....	398.02	.....	183.51	86.50	.....	301.01
27....	336.38	.....	71.16	35.50	.....	300.72
Mar. 1....	385.99	.....	72.90	.....	.....	313.09
2....	471.90	.....	86.53	.....	.....	385.37
3....	468.31	.....	26.22	.....	100.00	342.09
4....	451.68	.....	62.62	.....	.....	389.06
5....	418.12	.....	119.98	10.25	.....	308.39
6....	396.16	.....	96.63	.....	.....	299.53
7....	354.83	.....	100.36	47.25	.....	301.72
11....	434.60	.....	67.87	.....	.....	366.73
12....	421.58	.....	120.28	.....	.....	301.30
13....	411.39	.....	100.70	.....	.....	310.69
14....	347.87	.....	99.33	52.10	.....	300.64
15....	320.82	.....	142.16	100.20	.....	278.86
17....	441.01	.....	25.64	.....	100.00	315.37
18....	396.25	.....	94.80	.....	.....	301.45
	18,509.35	.....	3,523.36	362.83	500.24	14,848.68

Filed at Trial July 1, 1958.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS—C

It is hereby stipulated that, for the purpose of this case, the following statement may be accepted as fact and the exhibit referred to herein and at-

tached hereto is incorporated in this stipulation and made a part thereof.

Attached is an exhibit entitled "Walter F. Rau, Sr., Estate, Personal Living Expenses," which reflects all of the personal living expenses of Walter F. Rau for the years 1942, through 1947.

/s/ E. T. SIMPSON,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Walter F. Rau, Sr. Estate
Personal Living Expenses

Year	1942	1943	1944	1945	1946	1947
Withdrawals:						
Southern Hotel	$2,983.92	763.36	801.31	1,114.10	1,681.34	1,548.09
So. Wine & Liquor Store		437.40	350.00	1,566.74		
French Cafe	167.64	2,152.56	1,740.00		4.36	
W. F. Rau, Sr.	514.20	200.00	902.50	939.38	2,283.33	3,154.64
Sub-Total	$3,665.76	3,553.32	3,793.81	3,620.22	3,969.03	4,702.73
Additional Expenses paid by Southern Hotel	$ 620.94	860.70	1,096.02	1,416.56	621.20	
Medical expenses						2,046.46
Hotel Taft, Personal withdrawal					2,642.15	
Total personal living expenses	$4,286.70	4,414.02	4,889.83	5,036.78	7,232.38	6,749.19

Filed at Trial, July 1, 1958.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS—D

It is hereby stipulated that, for the purpose of this case, the following statements may be accepted as facts; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated.

1. That Mr. Emil Reed, Bakersfield, California, prepared the individual 1947 income tax return of Walter F. Rau, Sr.

2. That the income from the Southern Wine and Liquor Store, Bakersfield, California, for the year 1947, reported on the individual income tax return of Walter F. Rau, Sr. for the year 1947 was taken from Respondent's Exhibit U.

/s/ T. H. WERDEL,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Filed at trial July 21, 1958.

[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE AMENDMENT TO ANSWER

The Respondent moves for leave to file an amendment to answer in the above-entitled proceeding.

In Support Thereof respondent respectfully shows unto the Court that during the trial of the above-named case evidence of additional income in the form of overstated cash purchases in each of the years 1943 to 1946, inclusive, was introduced. Such overstated purchases result in additional income and increased deficiencies in income tax and additions to tax under Section 293(b) of the Internal Revenue Code 1939 for each of said years over amounts set forth in the notice of deficiency.

Wherefore, it is prayed that this motion be granted.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal
Revenue Service.

Filed August 18, 1958, T. C. U. S.

Granted August 29, 1958.

Served September 2, 1958.

[Title of Tax Court and Cause.]

AMENDMENT TO ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, Arch M. Cantrall, Chief Counsel, Internal Revenue Service, and amends the answer in said case to conform to the proof as shown in the trial of said case by further alleging as follows:

XI.

That for the years 1943 to 1946, inclusive, Walter F. Rau, Sr. fraudulently and intentionally overstated the cash purchases of the French Cafe on his income tax returns for said years in the following amounts:

Year	Amount
1943	$17,872.79
1944	24,140.70
1945	1,279.14
1946	1,969.91

XII.

That the overstated purchases shown in paragraph XI above result in additional income and increased deficiencies in income tax and additions to tax under Sec. 293(b), Internal Revenue Code 1939, in each of said years. Respondent hereby asserts and claims, under Sec. 272(e) of the Internal Revenue Code 1939, the increased deficiencies in income tax and additions to tax in the amounts as determined under a Rule 50 recomputation.

Wherefore, it is prayed

1. That petitioner's appeal be denied;

2. That the deficiencies in tax as set forth in the statutory notice of deficiencies and as increased by reason of the allegations of this amendment to answer be in all respects approved.

3. That the additions to tax for the taxable years involved as set forth in the statutory notice of deficiencies and as increased by reason of the allega-

tions of this amendment to answer be in all respects approved.

4. That this Court determine that the assessment of the deficiencies is not barred by the statute of limitations; and

5. That the deficiencies involved in this proceeding are due to fraud with intent to evade tax.

/s/ ARCH M. CANTRALL,
Chief Counsel, Internal
Revenue Service.

Filed August 29, 1958, T. C. U. S.

Served September 2, 1958.

[Title of Tax Court and Cause.]

REPLY TO AMENDMENT TO ANSWER

Comes now the Petitioner, by his attorney, Ellsworth T. Simpson, and for reply to Respondent's Amendment to Answer, respectfully states as follows:

XI. Petitioner denies that for the years 1943 to 1946, inclusive, that Walter F. Rau, Sr. fraudulently and intentionally overstated cash purchases of the French Cafe in his income tax returns for said years as set forth in Respondent's Amendment to Answer.

XII. Petitioner denies that the alleged overstated purchases result in additional income and in-

creased deficiencies in income tax and additions to tax under Section 293(b) Internal Revenue Code, 1939, in each of said years. Petitioner further denies that Respondent has established increased deficiencies for any of the years 1943 to 1946, inclusive, and, in support thereof, Petitioner respectfully advises the Court as follows:

1. The report of Revenue Agent L. A. Pope, dated October 4, 1949, and the schedules attached thereto, reflect that purchases for 1943 and 1944 had been decreased in the respective amounts of $18,-451.45 and $10,037.99.

2. Under date of January 5, 1954, a 30-day letter, addressed to W. F. Rau, Sr. by R. A. Riddell, Director of Internal Revenue, set forth the adjustments in the amounts indicated in the foregoing paragraph.

3. The Statutory Notice of Deficiency, dated January 17, 1956, referred to schedules previously submitted to the Petitioner as the basis upon which the deficiencies were proposed. It is apparent that the proposed additional income, as contained in the Statutory Notice of Deficiency, includes the alleged overstatement of purchases for the years 1943 and 1944; the allowance, therefore, of the Respondent's Amendment will result in duplication of increase in income.

4. The Respondent has failed to present computations relative to the allowance of additions to Petitioner's receipts as reflected on the daily cash

sheets of the French Cafe; Respondent merely seeks to increase the proposed assessment without giving any effect to such additions for the years 1943 to 1946, inclusive.

5. The evidence presented by the Respondent at the trial, upon which it is predicating its claim for increased deficiencies, was the testimony of Rose Goldstein. Her testimony is identical with that of the adjustments already proposed in the Statutory Notice of Deficiency as it relates to overstatement of purchases.

Wherefore, the premises considered, the Petitioner prays that:

1. Respondent's Amendment be disallowed.

2. That the additions to the tax be disapproved.

3. That this Court determine that the assessment of deficiencies for the years 1942 to 1944, inclusive, are barred by the Statute of Limitations and,

4. That the deficiencies involved herein are not due to fraud with the intent to evade payment of tax.

/s/ ELLSWORTH T. SIMPSON,
Counsel for Petitioner.

Received and filed September 15, 1958, T. C. U. S.

Served September 17, 1958.

Tax Court of the United States

Docket No. 61480

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Respondent determined deficiencies in tax and additions to tax for fraud, as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$ 6,230.87	$ 3,115.44
1943	Income and Victory	37,390.14	25,692.50
1944	Income	32,173.36	17,952.10
1945	Income	45,138.58	22,569.29
1946	Income	10,638.16	5,319.08
1947	Income	17,214.11	8,607.06

By amended answer, the respondent claimed additional deficiencies in tax and additions to tax for fraud, as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1943	Income and Victory	$ 15,523.36	$ 7,761.69
1944	Income	21,551.97	10,775.98
1945	Income	1,154.23	577.12
1946	Income	1,665.56	832.78

The principal issues are (1) whether the taxpayer filed false income tax returns for the years 1942-1947, by knowingly understating receipts and overstating purchases; and (2) whether petitioner is entitled to have the basic deficiencies determined on the basis of a net worth statement rather than on the basis of specific adjustments made by the Commissioner.

Findings of Fact

Some of the facts have been stipulated and, as stipulated, are incorporated herein by reference.

On May 12, 1952, the taxpayer, Walter F. Rau, Sr., was declared incompetent by court order. He died on January 4, 1953; he was then approximately 78 years of age. A bank was appointed executor, but it withdrew, and on March 9, 1955, Raymond J. Shorb was appointed as administrator with the will annexed.

Mary Agnes Rau, wife of decedent, died on December 27, 1942; he never remarried. Decedent had no dependents during the taxable years 1942 through 1947. He filed a separate return for 1942 on a community property basis. His individual returns for all the taxable years were filed with the collector of internal revenue at Los Angeles, California.

Commencing in 1932, and continuing to August 7, 1947, decedent, as sole proprietor, operated a business known as the Southern Hotel in Bakersfield, California. He owned and operated a business known as the French Cafe, located in the Southern Hotel,

from 1934 to May 6, 1946, at which time he formed a partnership with Phil Bender to operate that business. Decedent had a two-thirds interest in the partnership, which was terminated on August 16, 1947. On June 1, 1947, an equal partnership consisting of decedent, Phil Bender, and Robert R. Webb was formed for the purpose of conducting a business also known as the French Cafe, which was located across the street and about a block away from the Southern Hotel. This partnership continued to operate throughout the remainder of the year 1947. From 1934 to August 12, 1947, decedent, as sole proprietor, operated a business known as the Southern Wine and Liquor Store (hereinafter sometimes referred to as the Southern Bar or the Southern Wine and Liquor Bar), located in the Southern Hotel. Beginning in June, 1944, and continuing throughout the years in question, decedent owned and operated the Edmund Hotel in Venice, California. From 1944 to 1947, inclusive, he owned and operated the Sea Spray Hotel in Venice, California. In June, 1946, decedent purchased the Taft Hotel in Taft, California. He owned and operated this hotel together with its restaurant and bar from June, 1946, throughout the remainder of the period here involved.

The books and records of the French Cafe, Southern Hotel, and the Southern Bar were maintained on the cash basis of accounting under a single entry method of bookkeeping. Decedent made no entries in these books and records.

Robert Webb (hereinafter referred to as Webb) was hired as clerk of the Southern Hotel in 1932. In 1934 decedent gave Webb the title of manager. During the years 1942 to 1945 or 1946, Webb's hours of employment were from 7:00 a.m. to 7:00 p.m. In 1945 or 1946, an extra clerk was hired to assist Webb, and thereafter Webb's hours of employment were from 10:00 a.m. to 5:00 p.m. For some years Webb received $100 a month and room and board. In 1945 his salary was raised to $45 a week.

During 1940 and 1941, Webb received illegal income in the form of commissions on bets on horse racing using a telephone in the Southern Hotel for this operation. On some days his commission would run as high as $15. Webb did not want to stop this illegal business of taking bets on horse racing, but the business was taken away from him.

Webb's hotel duties included hiring and supervising bellboys and maids, keeping order in the hotel, and acting as room clerk. He also, at all times material herein, had charge of the receipts of the French Cafe and Southern Bar. He had nothing to do with the hiring or firing of employees of the French Cafe, Southern Bar, or other businesses of decedent.

Rose Goldstein was employed by the decedent in 1935 as a bookkeeper. She married Jack Longway on July 22, 1942. She kept the books of the Southern Hotel, the French Cafe, and the Southern Bar. Her duties as bookkeeper for the Southern Hotel and the Southern Bar ceased when the Southern Hotel was demolished in August, 1947. Her duties

as bookkeeper for the French Cafe ceased on May 6, 1946, when decedent formed a partnership with Phil Bender to operate this business. She substituted for Webb when he was on vacation or absent on account of illness. For her services to decedent she received $10 per month, one or two meals a day, and desk space in the lobby of the hotel where she conducted a business of her own.

The services Rose Goldstein performed for decedent did not take up much of her time. In her own business she realized income from services rendered as a public stenographer, notary public, mimeographing, telephone answering, and direct mail advertising. She also prepared income tax returns and did some court reporting. After her marriage in 1942 she continued to operate this business under the name of Rose Goldstein.

Decedent had bank accounts in the Bank of America National Trust and Savings Association, Bakersfield, California, for the French Cafe, Southern Bar, and the Southern Hotel, and also a bank account for the French Cafe in The Anglo California National Bank, Bakersfield, California. He had a personal account and a safety deposit box at the Anglo Bank. Webb was authorized by the decedent to draw checks on the bank accounts of the French Cafe and Southern Bar, and he drew checks on these accounts to meet payroll and other expenses.

Webb endorsed the name of decedent on checks drawn by Robert Webb, payable to decedent on the dates and in the amounts set forth in the following schedule:

Date	Check No.	Amount of Check
April 7, 1947	753	$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
Total		$7,300.00

Practically all of the deposits for all of the taxable years to the various bank accounts of decedent's businesses, including those to his personal bank account, were made by Webb in the form of cash and checks. Webb went to the bank every day, sometimes three or four times a day, to make deposits. The amounts deposited as the receipts of the French Cafe and the Southern Bar were entered daily during the years 1942 through 1947, in "year books," consisting of a diary-type volume for each year with a half page or page for each day of the year.

Decedent sometimes gave Webb cash and told him to convert the cash into thousand dollar bills. Decedent would put these bills in his safe deposit box at the Anglo Bank. On one occasion when Webb accompanied decedent to the bank, decedent had twenty $1,000 bills when he returned from a visit to the box and bought $20,000 worth of war bonds. Decedent told Webb he made this purchase and Webb saw him make it.

Every morning during the years 1942 to May 6, 1946, when Webb reported for work, the steward or the cashier of the French Cafe would bring him a sheet containing figures showing its receipts for the preceding day, the cash register tape, and the cash

receipts. The amount of the daily receipts as shown on the cash register tape would be entered at the top of the sheet, and from this amount there would be deducted "payouts" for the expenses of the day. Following instructions received by him from decedent Webb would deduct and remove from the net receipts of the day thus determined $10 every day of each month and in addition thereto $100, $150, or $200, on Saturdays, Sundays, and holidays. Usually the amount deducted was shown on the daily sheet, but in some instances the deduction made was not reflected on the sheet.

The $10 deducted by Webb each day from the net receipts of the French Cafe was placed by Webb in an envelope marked "French Cafe" and this envelope was placed in decedent's safe. Decedent instructed him to do this. At the end of the month the envelope would contain an amount ranging from $280 to $310 depending on the number of days in the month. Webb would then take this amount out of the envelope and give it to decedent, who would have it deposited in his personal bank account, put it in his safe deposit box at the Anglo Bank, or put it in his pocket. When the money was removed, the envelope would be destroyed, and Webb would start the next month with a new envelope.

The larger amounts deducted from cash receipts on Saturdays, Sundays and holidays were placed in another envelope marked "French Cafe" and on the outside of this envelope Webb would note the amount deducted and the date of the deduction. Webb would get the receipts of a Saturday, Sunday,

or holiday on the morning of the following day, show them to the decedent, and he would tell Webb the amount to be deducted from the receipts in addition to the $10 daily deduction.

At times, after deducting the usual $10 from the daily net receipts of the French Cafe or the larger amount on a Saturday, Sunday, or holiday, the resulting figure would be below $300. Webb was instructed by decedent in such instances to make out a check payable to cash in an amount which, when added to the receipts as thus reduced, would produce a figure in excess of $300. Such check would be drawn upon the account of the French Cafe, and the proceeds thereof would be added to the receipts. The purpose of adding the proceeds of such check to the receipts, after the $10 or larger deduction had been taken from the actual net receipts, was to make the receipts and deposit for the day "look respectable." Although the addition of the amount of the check to the net receipts for the day increased the receipts and the deposit for that day by that amount, the increase was neutralized for tax purposes by the fact that the amount of the check was falsely entered on the check stub as an expenditure for supplies and was entered on decedent's books as such an expenditure by the bookkeeper. Pursuant to instructions she received from decedent and Webb the amounts of these checks were treated as expenditures for supplies during each of the years 1942, 1943, 1944, 1945, and up to May 6, 1946, even though these amounts did not represent expenditures for supplies.

The Southern Bar operated on two shifts, one ending at 4:00 p.m. and the other ending at midnight or 2:00 a.m. Webb would receive the cash receipts from the bar from the day bartender at 4:00 p.m. and from the night bartender the following morning. He would then total the cash receipts for the day, and deduct the amount of "payouts" for expenses. Decedent instructed him to deduct and remove each day from the net receipts thus determined the amount of $25 and he followed these instructions. Webb put the $25 daily withdrawal in an envelope marked "Bar" which was placed in the safe. Decedent also instructed him to deduct an additional larger amount on Saturdays, Sundays and holidays. This amount was usually $100, but when the receipts were exceptionally large, the amount was $150 or $200. Decedent decided how much would be "taken off" on such days. The larger amounts thus deducted on week ends and holidays were placed in the comparable envelope for similar deductions made on such days from the receipts of the French Cafe. When decedent was absent, Webb would deduct $100 but would save the cash register tape for decedent who would examine it on his return. The practice of deducting $25 a day started at the beginning of 1942 and continued until a short time before the Southern Bar was closed in August, 1947. The practice of deducting additional large amounts on week ends started at the beginning of October, 1942, and continued at least through July, 1947.

When Webb was absent on leave or because of illness, Rose Goldstein handled the receipts of the

French Cafe and the Southern Bar. On these occasions the same deductions were taken from the daily and week end receipts of these businesses that were taken by Webb when he was present. Decedent told her the amounts to be taken as deductions from the daily and week end receipts.

Every day, except when he was absent, Webb recorded the daily receipts of the French Cafe and the Southern Bar in "year books" during the years 1942 through August 10, 1947. When he was absent, Rose Goldstein recorded the receipts from 1942 to May 6, 1946, in the case of the French Cafe, and from 1942 to August 10, 1947, in the case of the Southern Bar.

The receipts for the French Cafe recorded in the "year books" were not the actual receipts for the years 1942 to May 6, 1946, inclusive. Disregarding any additions to receipts represented by the proceeds of the foregoing checks payable to cash which were falsely treated as expenditures for supplies and which thus neutralized such additions, the recorded receipts of the French Cafe during that period were understated in the amount of $10 per day on every calendar day and were also understated in addition by at least $100 for each Saturday, Sunday, and holiday.

The receipts for the Southern Bar that were recorded in the "year books" were not the actual receipts for the years 1942 to August 10, 1947, inclusive. The recorded receipts were understated in the amount of $25 per day on every calendar day

throughout that period and were also understated in addition by at least $100 for each Saturday, Sunday, and holiday from the beginning of October, 1942, until at least the end of July, 1947. The aggregate of such understatements of receipts from the Southern Bar for 1942 was $12,325.

The amounts that were given to Rose Goldstein, and recorded by her in the cash journal as the daily receipts of the French Cafe and the Southern Bar, were the amounts entered daily in the "year books" during the years 1942 to May 6, 1946, in the case of the French Cafe and the amounts entered daily in the "year books" during the years 1942 to August 10, 1947, inclusive, in the case of the Southern Bar.

The income tax returns of decedent for 1942 to 1946, inclusive, were prepared by Rose Goldstein and she used the check books and the cash journal in preparing these returns. The income tax return of decedent for 1947 was prepared by Emil Reed, and the income of the Southern Bar shown thereon was taken from the cash journal.

The income tax returns of decedent for 1942 to 1947, inclusive, did not reflect the amounts withheld, and not recorded in the cash journal, from the receipts of the French Cafe and the Southern Bar.

Overstatement of Purchases for French Cafe.

The receipts that were recorded on the daily sheets of the French Cafe and in the year books were always reduced by amounts actually paid out in cash for supplies and these amounts were frequently

characterized as "paid out" or "payouts" on the daily sheets.

The cash journal of the French Cafe reflects cash purchases of $17,872.79 for 1943, $24,140.70 for 1944, $1,279.14 for 1945, and $1,969.91 for 1946. The recording in the cash journal of these amounts, which had already been deducted from receipts on the daily sheets, resulted in a duplication and overstatement of cash purchases.

In addition to the above-mentioned cash purchases, purchases made by check, including the amounts of the fictitious purchases (supra) added to receipts, were recorded in the cash journal. Purchases for the French Cafe are shown in the cash journal in the amount of $48,339.67 for 1943 and in the amount of $45,906.93 for 1944. Purchases for the French Cafe are shown on the individual income tax returns of decedent for 1943 and 1944 in the amount of $66,791.12 for 1943 and in the amount of $55,944.92 for 1944. Purchases for the French Cafe for 1943 and 1944 are substantially overstated in these returns.

Inventories.

The individual income tax return of decedent for 1943 reflected opening and closing inventories for the French Cafe and for the Southern Bar. Prior to that time inventories were not used to determine income.

The individual income tax return of decedent for 1944 reflected an opening and a closing inventory

for the Southern Bar. Inventories were not used in subsequent returns to determine income.

The decedent's income tax return for 1943 shows an opening inventory for the French Cafe of $3,500 and a closing inventory of $1,050, and an opening inventory for the Southern Bar of $16,452.65 and a closing inventory of $1,695. His income tax return for 1944 shows an opening inventory for the Southern Bar of $1,695 and a closing inventory of $3,050.62.

Actual inventories were not kept for the French Cafe and for the Southern Bar for the years 1943 and 1944 and the books and records of the French Cafe and Southern Bar do not reflect that inventories were kept for those years. The inventory figures that were used by the bookkeeper to determine income were given to her by the decedent without any verification.

Fraud.

The amounts withheld from the gross receipts and not recorded as receipts in the "year books" and cash journal during the years 1942 to May 6, 1946, in the case of the French Cafe and during the years 1942 to August, 1947, inclusive, in the case of the Southern Bar, went to the decedent.

The amounts that were withheld and not recorded as receipts, that went to decedent from the Southern Bar for the years 1942 to August 10, 1947, inclusive, were withheld with the knowledge, consent and specific instructions, and frequently with the direct participation of the decedent.

The amounts that were withheld and not recorded as receipts, that went to decedent from the French Cafe for the years 1942 to May 6, 1946, were withheld with the knowledge, consent and specific instructions and frequently with the direct participation of the decedent.

Rose Goldstein was instructed by decedent to show in the cash journal amounts totalling $17,872.79 for 1943, $24,140.70 for 1944, $1,279.14 for 1945, and $1,969.91 for 1946, representing cash purchases of the French Cafe, and these amounts were reflected in purchases when the income tax returns were prepared, even though they had already been subtracted from the receipts of the French Cafe for the years 1943-1946.

When the bookkeeper, Rose Goldstein, had the income tax figures made up for 1943, and showed decedent what tax he had to pay, he told her to "boost" the purchases so he would not have much income tax to pay, or none, and she complied with his instructions.

When the bookkeeper, Rose Goldstein, had the figures prepared to put in the income tax return for 1944, she showed them to decedent who instructed her to raise the purchases, and she complied with his instructions.

When the bookkeeper, Rose Goldstein, had the figures prepared to put in the income tax return for 1944, she showed them to decedent who instructed her to raise the purchases, and she complied with his instructions.

Decedent knew that the books and records used to determine income of the French Cafe for the years 1942 to May 6, 1946, and of the Southern Bar for the years 1942 to August 10, 1947, were false and that they did not accurately reflect income.

Decedent knew that his individual income tax returns for the years 1942 through 1947 were false and fraudulent and that he had understated his income in substantial amounts for each of the years.

Decedent's Health.

Decedent habitually used alcoholic beverages and at times drank to excess. During the period August 24, 1942, to September 21, 1945, he visited a doctor at least six times. He was under the influence of alcohol on each of these visits and was brought in or assisted into the doctor's office. During the three years the doctor treated decedent there was a decline in his physical health. The doctor treated him for alcoholic neuritis, arthritis, thrombophlebitis and myocarditis.

In the latter part of 1945, decedent was confined to his rooms in the Southern Hotel for a period of three weeks. He employed a practical nurse who cared for him during this period. She remained in his employ until he died. During these three weeks he was in bed most of the time. He had been drinking and not eating. At the end of the three-week period, he had difficulty walking and was in a wheel chair for a short time. Webb was almost a daily visitor to decedent's room during the three-week period.

In 1946 decedent and his nurse moved from the hotel to a house which decedent had purchased. Thereafter, until he had a stroke in December of 1947, he visited the hotel practically every day. His nurse would drive his car. He did not stay at the hotel very long during these visits. When the hotel was closed in August, 1947, decedent was in the lobby nearly every day until the hotel was demolished. Decedent had trouble with his legs and was required to use a wheel chair in 1947. He was under the care of another doctor from the latter part of 1946 until he died. The doctor treated him for marked phlebitis. The first time this doctor hospitalized decedent was in December, 1947, when he had the stroke.

At all times material herein, the decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar, checked on the daily receipts and payouts of these businesses, gave instructions as to the daily and week end withdrawals from the receipts of these businesses, made it a practice to know everything that was going on, and closely supervised the affairs of these businesses. During the years 1942 through 1946, and until he had a stroke in December, 1947, he was mentally alert and had a keen mind insofar as his businesses were concerned.

Webb—Bank Accounts and Deposits.

Webb had a personal checking account in the Bank of America during the years 1942 through 1947, and maintained a safe deposit box in that bank where he kept cash. He never deposited any

of the receipts from the French Cafe or the Southern Bar in his bank account.

Among the deposits made by Webb in his personal bank account in the Bank of America during the year 1947 were the following:

Date	Amount
May 27, 1947	$1,200.00
May 29, 1947	916.83
May 29, 1947	3,600.00
June 2, 1947	5,000.00
June 13, 1947	1,000.00

Webb was married in 1938. He and his wife lived at the Southern Hotel and received room and board. In 1942 they moved into a completely furnished house owned by decedent which they rented for $40 a month. They had very little expense except the $40 monthly rental since they ate many of their meals at the hotel. From 1938 through 1947 Webb's wife was employed and received a salary of about $150 a month. They tried to save $100 per month and many months they were successful in doing this. They invested some of their savings in war bonds. On or about June 1, 1947, Webb invested $12,000 in the partnership formed to operate the French Cafe. The source of this $12,000 was the proceeds of the sale of war bonds and money in his safe deposit box and in the bank. This money was deposited in the Bank of America, and Webb paid $12,000 for his partnership interest.

Bank Deposits—Rose Goldstein.

Among the deposits made by Rose Goldstein in her personal bank account during the years 1943,

1944, 1945, 1946 and 1947, representing income derived from her business, were the following:

Date	Amount of Deposit
March 9, 1943	$ 946.10
March 19, 1943	468.30
March 17, 1943	1,297.23
September 23, 1943	559.94
July 11, 1944	900.00
March 17, 1945	604.00
January 31, 1946	3,642.88
April 2, 1946	1,000.00
May 9, 1946	1,150.00
June 10, 1946	800.00
June 17, 1946	400.00
September 16, 1946	512.79
September 20, 1946	600.00
October 14, 1946	1,680.00
March 4, 1947	500.00
March 29, 1947	1,902.28
September 19, 1947	2,409.35
August 8, 1947	1,500.00

The total deposits in the personal bank account of Rose Goldstein during the years 1943 through 1947 were as follows:

Year	Total Deposits
1943	$ 5,954.68
1944	3,901.15
1945	3,641.74
1946	14,439.85
1947	12,401.86
	$40,339.28

Decedent followed a consistent pattern of deliberately understating receipts of the French Cafe for 1942 to May 6, 1946, inclusive, and of the Southern Bar for 1942 to August 10, 1947, inclusive.

Decedent deliberately overstated purchases for the French Cafe in 1943, 1944 and 1945, despite repeated objections by his bookkeeper.

Decedent caused such books and records as were kept on his behalf to omit specific items of income for the years 1942 to 1947, inclusive, and to overstate specific items that reduced income for the years 1943, 1944 and 1945.

Decedent caused false entries to be made in his books and records for the years 1942 to 1947, inclusive.

Decedent filed false and fraudulent income tax returns for the taxable years 1942 to 1947, inclusive, and part of the deficiencies for each of these years was due to fraud with intent to evade tax.

Opinion

Raum, Judge:

The Commissioner made a determination of fraud for each of the years involved, 1942-1947, and we think his proof overwhelmingly establishes fraud. The testimony of Robert Webb and Rose Goldstein was strong and convincing, and was in part corroborated by documentary evidence. Although there may have been minor inconsistencies, the main thrust of their testimony was credible, consistent,

powerful, and persuasive. We have no doubt on the evidence that, pursuant to explicit instructions of the decedent, false and fraudulent returns were prepared which understated receipts and overstated purchases. No useful purpose would be served by reviewing the evidence. Our finding of fraud not only lifts the bar of the statute of limitations as to 1942-1944[1], but also supports the application of Section 293(b), Internal Revenue Code of 1939, with respect to the 50 per cent addition for fraud for each of the years involved.

As to the basic deficiencies, the evidence strongly supports the Commissioner's adjustments (including those embodied in his amended answer) as to each item in controversy, except as to the receipts from the Southern Bar for the year 1942, which will be discussed below. Indeed, apart from the year 1942, the evidence would support adjustments of unreported income in excess of those determined by the Commissioner in his notice of deficiency and claimed in his amended answer.[2] Certainly, peti-

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[1]No question as to limitations with respect to the remaining years is presently in issue.

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[2]Thus, the Commissioner added $13,010 to the income of the French Cafe for the years 1942, 1943, and 1945, and $13,020 for 1944. However, based upon the decedent's practice of understating gross receipts by $10 for each calendar day of the year, as well as by at least $100 for each Saturday, Sunday, and holiday, the amount that the Commissioner might have restored to income for each year could have been at least $14,550. The latter figure is based upon 365 calendar days at $10 each, 104 Saturdays

tioner has shown no error in the Commissioner's determination, and the Commissioner has fully carried the burden which rests upon him in respect of his allegations in the amended answer.

Petitioner contends, however, that income should be determined in accordance with a net worth statement presented to the Court. In the first place, the net worth statement itself shows substantial amounts of unreported income, although less than those determined by the Commissioner's specific adjustments. Moreover, there is no rule of law requiring the use of the net worth method. To be sure, the net worth system is an acceptable method of determining income in the absence of a more precise method. But it may be less reliable than adjustments based upon specific items. See in this respect, Emilie Furnish Funk, 29 T.C. 279, 291-293, affirmed on this issue, 262 F. 2d 727 (C.A. 9). And, on the present record, we are satisfied that the evidence as to specific items furnishes a more accurate guide to the computation of decedent's net income than the net worth statement.

As to the year 1942, the record requires a revision of the basic deficiency in one respect, because

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and Sundays, and five holidays at $100 each. Moreover, the Commissioner would have been justified in adding further an amount for those days in which more than $100 was withheld from gross receipts by the decedent. Therefore, had the Commissioner increased the adjustment of the income of the French Cafe for each of those years by $2,000, such further adjustment would have been fully supported by the record.

the evidence as to unreported receipts from the Southern Bar supports the Commissioner's determination only in part. Webb testified that the practice of removing $25 a day from the receipts of the Southern Bar began in the "first part" of 1942 and that the practice of removing the larger amounts ($100 or more) on week ends and holidays commenced "a few months after the war started." Subsequently, he testified that the practice of removing the larger amounts from the receipts of the Southern Bar began in the "latter part of 1942." Using our best judgment on the evidence we have found that the receipts from the Southern Bar were understated in the amount of $25 a day for each calendar day throughout the year 1942 and were further understated by at least $100 for every Saturday, Sunday, and holiday during the months of October, November and December of 1942. Also, using our best judgment we have found that the aggregate of such understatements of receipts from the Southern Bar was $12,325 for 1942. However, the Commissioner's determination fixes $16,925 as the amount of income from the Southern Bar that was withheld by the taxpayer in 1942 and unreported. Thus, that determination was excessive by $4,600. But, as shown in footnote 2, supra, the Commissioner's adjustment in respect of receipts from the French Cafe in 1942 should have been $2,000 more than it was, with the consequence that the net determination of additional income for 1942 (of the Southern Bar and French Cafe combined) was excessive by $2,600. Accordingly, the deficiency for

1942 should be recomputed so as to take into account the difference of $2,600, which, however, must in turn be reduced by 50 per cent, since the taxpayer filed a separate return for 1942 on a community property basis.

Petitioner's brief suggests as an issue herein "the question of the survival of the fraud penalty imposed subsequent to the death of the taxpayer." No such issue was raised in the pleadings, and it is not properly before us. Moreover, petitioner's brief admits that the decisions of the Court on that issue are unfavorable to petitioner, and it presents no argument with respect thereto.

Decision will be entered under Rule 50.

[Seal]

Filed June 8, 1959.

Served June 8, 1959.

[Title of Tax Court and Cause.]

MOTION FOR FURTHER TRIAL

Comes now the Petitioner by his Counsel, Ellsworth T. Simpson, and moves this Court to reopen this proceeding for the purposes of permitting the Petitioner to introduce evidence which, in view of the opinion of this Court entered June 8, 1959, is essential to a decision in this case and, for the purposes of having this Court reconsider and, if the

Court deems such action proper, vacate or revise its previous opinion.

In support of this Motion, the Petitioner states as follows:

I.

Involved in this proceeding are the following questions:

1. Whether the evidence presented by the Respondent is clear and convincing justifying the imposition of the fraud penalty within the meaning of Section 293(b) I.R.C., 1939.

2. Whether the net-worth of Petitioner's Decedent, to which Respondent and Petitioner have stipulated, may be properly rejected in favor of oral testimony for the purposes of determining taxable income.

3. Whether oral testimony constitutes, in the judicial concept, "specific items" justifying the rejection of the net-worth method.

4. Whether deficiencies proposed in the Statutory Notice of Deficiency may be increased in the absence of proof establishing that Petitioner's Decedent was in possession of funds separate and apart from his net-worth as stipulated to between the parties.

5. Whether evidence in the form of oral testimony, seeking to increase taxable income in excess of the stipulated net-worth, constitutes evidence at variance with the stipulations.

6. Whether evidence of the personal banking transactions of two former employees, entrusted with the management of funds may be ignored in increasing the deficiencies in excess of those resulting from use of the net-worth method, especially when such transactions, as in this case, approximate the amount by which the originally proposed assessment is increased.

II.

During the course of the hearing, Judge Arnold Raum stated as follows: "If any of the funds were diverted to the witness (Rose Goldstein), I would think that they would have a bearing upon this case, and if Counsel for Petitioner has any proper evidence to show that there has been such diversion, I would admit such evidence." (Tr. 592.) By reason of such statement, it is now imperative to a proper decision of this case, to request a reopening to allow the submission of evidence bearing upon the income of witnesses Robert Webb and Rose Goldstein for the period 1942-1947, inclusive; Petitioner also desires to submit evidence of all banking transactions including safety deposit boxes and savings accounts about which Petitioner had no knowledge or means of ascertainment thereof prior to the hearing.

III.

Petitioner requests that this Court issue an order requiring Respondent to produce witnesses, Robert Webb and Rose Goldstein, and further directing that they make available to Petitioner all information referred to in Paragraph II hereof including

the original income tax returns, and should they not be available, copies of such returns, for each of the years 1942-1947, inclusive. In the opinion of Judge Raum, the testimony of Webb and Goldstein was "credible, consistent, powerful and persuasive." It is apparent, therefore, that Petitioner is required to trace the diversion of funds from the Petitioner's Decedent to either or both Robert Webb and Rose Goldstein by vitue of the fact that the determination of the income of Petitioner's Decedent is predicated upon their testimony.

IV.

This Court has not heretofore determined that oral testimony constitues "specific items" nor that it constitutes a "more precise method" than that of the net-worth method for determining taxable income. The case of Emilie Furnish Funk, 29 T. C. 279, 293-293, also decided by Judge Raum, was referred to in support of that proposition. The net-worth of the Petitioner in the case of Emilie Furnish Funk contained numerous inaccuracies; there is no evidence of inaccuracies in the net-worth stipulated to between Petitioner and Respondent in this proceeding.

V.

During the course of the hearing, the Trial Judge indicated, by statements and general demeanor, a pre-deposition favorable to Respondent; on one occasion, he questioned, in open Court, the good faith of Counsel for Petitioner. Illustrations of the foregoing are set forth as follows:

(a) During the cross-examination of Robert Webb, testimony had been elicited by Counsel for Petitioner relative to Petitioner's Exhibit 16, being a check drawn by Webb under date of May 2, 1947, in the amount of $1,200.00 on the bank account of Petitioner's Decedent bearing the endorsement "W. F. Rau," admittedly in the handwriting of Robert Webb; this Exhibit was used in conjunction with Petitioner's Exhibit 12 being a record of a deposit to Webb's personal bank account on May 27, 1957, in a like amount; Webb stated that the source of this deposit could have been from the check drawn by him on his employer's bank account and endorsed by him as hereinbefore described. Webb was being interrogated by the Court on this aspect of the evidence and apparently was attempting to explain the source of the funds deposited to his personal bank account; at this point, the Court interrupted the witness and called his attention to a lapse of 25 days between the cashing of the check and the deposit to his personal bank account; the witness then replied, "Well, that is a different deal then." (Tr. 213-217.)

(b) Dr. John J. McCarthy, a witness called in behalf of Petitioner's Decedent, had testified regarding the mental deterioration of Mr. Rau; as Counsel for Respondent undertook his cross-examination, the Court intervened to ask Dr. McCarthy the following question: "In your judgment, was he sufficiently rational, however, that you would

have felt justified in cashing a check that he might have given you for your fee?" (Tr. 415-416.)

(c) On cross-examination of Dr. John J. McCarthy, Counsel for Respondent asked the following question: "How many drinks would you have with him (Mr. Rau when you would see him at the bar, say in 1942?"; upon objection by Counsel for Petitioner's Decedent to this question the Court stated that the number of drinks the witness had was of no relevance but continued to state as follows: "I am satisfied as to the good faith of Government's Counsel, and I think it might have some relevance. This being cross-examination, I will permit him to continue." (Tr. 420.)

(d) On cross-examination of Dr. Seymour Strongin, a witness called in behalf of Petitioner's Decedent, Counsel for Respondent asked the witness if he would describe Mr. Rau as a "strong-willed individual." The witness replied, "No, on the contrary, he seemed to have flights of fancy, and—"; at this point, Counsel for Respondent stated that the answer was not responsive to the question. The Court then made the following observation: "The question related to whether or not Mr. Rau was strong-willed. My impression of the answer which the witness started to give was that it did not start out to be responsive to the question, but I will permit the witness to continue with the expectation that he may come around to answering the question that was put to him." (Tr. 397.)

(e) Petitioner had offered in evidence Exhibits 13, 14, 15 and 16, consisting of a number of checks, some of which bore the signature of W. F. Rau and some of which bore the signature of Mr. Robert Webb; Exhibit 14 consisted of five checks all of which contained the endorsement, "W. F. Rau," which Webb admitted were in his handwriting; the dates and the amounts are as follows:

Date	Check No.	Amount of Check
April 7, 1947	753	$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
Total		$7,300.00

As to Exhibit No. 16, being a check dated May 2, 1947, in the amount of $1,200.00 drawn by Robert Webb and containing the endorsement "W. F. Rau" which Webb admits to be in his handwriting, the Court made the following observation: "You haven't established that this witness got these monies for his own personal useage. There is certain amount of smoke that has been generated, but I haven't seen any fire yet. You are not going to establish any more by just bringing more checks in, unless you can bring them in with a more light to them than you have brought in, with respect to those.

"Perhaps I have myself, apprehended some of the testimony, and if I have, then on brief, you can point out to me the power of the strength that there

lies behind these checks. But I have tried to follow it attentively, the course of the trial, and simply for your own benefit, I am telling you that as of now, the matters resolving around these checks seem to me to be rather inconclusive." (Tr. 229-230.)

(f) During the cross-examination of Respondent's witness, Rose Goldstein, Counsel for Petitioner's Decedent was inquiring into a previous examination of Mr. Rau's income tax returns and the kind of records that were made available to him by Rose Goldstein (the bookkeeper) for that purpose: Counsel for Petitioner had stated to the Court as follows: "Of course, I think it was natural for me to assume that this person who was a bookkeeper, being present at the time this audit was being made, would have had knowledge of the fact that he was there, making the audit, and that these assessments had been made. I did not realize that she would say she doesn't remember." The Court then stated, "I am not satisfied, Mr. Simpson, with the bona fides of your statement. If the agent saw these sheets, the agent was the man from whom to get that information. The notice of trial in this case was sent out, according to the records, before me, on March 13 of this year, and the agent, himself, would be the most direct source to the evidence as to whether such sheets were made available to him. This witness testified that she was no longer working for Mr. Rau at the time this agent's report was prepared. At the very best, you could get only indirect evidence from this witness. The most direct

evidence would be from the agent. And there has got to be some kind of orderly conduct in the trial of the lawsuit. It is up to Counsel to present their evidence and present it at the time the case is called for trial. If some new and unsuspected development had arisen during the course of the trial, that would justify keeping the record open. I think if justice required it, I would keep it open, but in my judgment, no new and unsuspected development has occurred. In my judgment, the matter for which you ask me to keep the record open is a matter that plainly should have been anticipated at the time the case was being prepared for trial. Deposition, at best, is not a satisfactory way of presenting evidence to a Court. It has to be resorted to at times, because there is no better way of handling the matter. But the Court is now in session. It is prepared to receive such evidence as the parties have to present in the lawsuit. I will not keep the record open beyond the period that the Court is in session in Los Angeles. Now, I do expect this present session to last for some, at least for some three or four weeks beyond today, and I will keep the record open up to the end of this session, and if you can bring in the witness, bring in Mr. Slatter, or whatever his name is, during the period that the Court is in session, I will receive his testimony, but not beyond that."

Mr. Simpson: All right, your Honor, thank you. Only one observation, You ("I") question the good faith of my statement. I would like to say something in my (own) regard.

"Being a bookkeeper, I did assume, and I think rightly so, that she would have knowledge of this examination which I know was conducted prior to the time he submitted his report. It had to be prior to December of 1947, and for that reason, I assumed that this witness would be familiar with that audit and examination, and not believe at that time that she would not recall it.

"And I honestly believe that she would have testified with respect to that audit, and I made those representations in good faith." (Tr. 536-538.)

On Monday, July 14, 1958, Mr. Walter Slater, the Revenue Agent who had conducted the examination of Mr. Rau's income tax returns for the years 1942-1944, inclusive, was called to testify in that regard: he testified that he made his examination in the fall of 1946, and that the examination covered a period of four or five days; that he consulted Rose Goldstein with respect to the books and records. (Tr. 629 et seq.).

Wherefore, in the light of all the circumstances prevailing herein, and more particularly the views of the Trial Judge relating to diversion of funds from the Decedent, and the necessity of establishing actual defalcation of Decedent's funds, notwithstanding the failure of Respondent to establish that Decedent was in possession thereof, the Petitioner prays that this Court will reopen this proceeding to permit the introduction of additional evidence, and in the light of such additional evidence, recon-

sider and vacate or revise its opinion entered June 8, 1959.

/s/ ELLSWORTH T. SIMPSON,
Counsel for Petitioner.

Filed June 18, 1959, T.C.U.S.

Denied: June 23, 1959, John E. Mulroney, Acting Chief Judge.

Served June 24, 1959.

[Title of Tax Court and Cause.]

RESPONDENT'S COMPUTATION FOR ENTRY OF DECISION

The attached computation is submitted on behalf of the respondent, in compliance with the opinion of the Court determining the issues in this case, reflecting petitioner's tax liabilities for the years 1942 to 1947, inclusive, as follows:

1942			
Deficiency in income tax (to be assessed)			$ 5,901.47
Addition to the tax (Section 293(b), 1939 Code, to be assessed)			2,778.22
1943			
Income and victory tax liability			72,712.40
Tax liability per return:			
Original—Paid	$ 2,868.23		
Not Paid	2,935.80	$ 5,804.03	
Additional—Paid		13,994.87	
			19,798.90

Deficiency (statutory) in income and victory tax (to be assessed)			$ 52,913.50
Addition to the tax (Section 293(b), 1939 Code, to be assessed)			33,454.19
1944			
Income tax liability			74,912.03
Tax Liability per return:			
Original—Paid	$ 13,819.47		
—Not Paid	3,636.40		
		$17,455.83	
Additional—Paid		3,730.83	
			21,186.70
Deficiency (statutory) in income tax (to be assessed)			53,725.33
Addition to the tax (Section 293(b), 1939 Code, to be assessed)			28,728.08
1945			
Deficiency in income tax (to be assessed)			46,292.81
Addition to the tax (Section 293(b), 1939 Code, to be assessed)			23,146.41
1946			
Income tax liability			66,844.27
Tax liability per return:			
Original—Paid	$ 53,017.30		
—Not Paid	1,523.25		
			54,540.55

Deficiency (statutory) in income tax (to be assessed)	12,303.72
Addition to the tax (Section 293(b), 1939 Code, to be assessed)	6,151.86

1947

Deficiency in income tax (to be assessed)	$17,214.11
Addition to the tax (Section 293(b), 1939 Code, to be assessed)	$ 8,607.06

This computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ HERMAN T. REILING, W.B.R.
Acting Chief Counsel,
Internal Revenue Service.

Without prejudice to the right of appeal, it is agreed that the attached computation (correctly summarized above) is in accordance with the opinion of the Tax Court in the above-entitled case.

/s/ ELLSWORTH T. SIMPSON,
Counsel for Petitioner.

Aug. 5, 1959.

Recomputation Statement

In re: Estate of Walter F. Rau, Sr., Deceased,
Raymond J. Shorb, Administrator,
with the will annexed

c/o Burum and Young.
506 Haberfelde Building,
Bakersfield, California.

Docket No. 61480

Year	Statutory Deficiency	Unpaid Original Tax	Prepayment Credit Adjustment	Deficiency to Be Assessed and Paid
1942—Income Tax	$ 5,556.43	$345.04		$ 5,901.47
50% Penalty	2,778.22			2,778.22
1943—Income and Victory Tax	52,913.50		$2,935.80	55,849.30
50% Penalty	33,454.19			33,454.19
1944—Income Tax	53,725.33		3,636.40	57,361.73
50% Penalty	28,728.08			28,728.08
1945—Income Tax	46,292.81			46,292.81
50% Penalty	23,146.41			23,146.41
1946—Income Tax	12,303.72		1,523.25	13,826.97
50% Penalty	6,151.86			6,151.86
1947—Income Tax	17,214.11			17,214.11
50% Penalty	8,607.06			8,607.06
Total Income Tax	$188,005.90	$345.04	$8,095.45	$196,446.39
50% Penalty	102,865.82			102,865.82

The recomputation of tax and penalty shown herein is in accordance with the memorandum findings of fact and opinion of The Tax Court of the United States filed June 8, 1959, for decision to be entered under Rule 50.

The recomputation reflects the increased deficiency and penalty claimed in the Commissioner's amended answer.

Adjustment to Income
Year 1942

Net income per deficiency notice dated 1/17/1956	$20,186.90
Decrease:	
(a) Business income overstated	1,300.00
Net income as adjusted	$18,886.90

Explanation of Adjustment

(a) The Tax Court has held that business income is overstated as follows:

Additional receipts Southern Bar per deficiency notice	$16,925.00
Additional receipts per Tax Court opinion	12,325.00
Overstatement	$ 4,600.00
Receipts from French Cafe understated per Tax Court opinion	2,000.00
Net overstatement of income	$ 2,600.00
Petitioner's ½ community share	$ 1,300.00

Computation of Tax
Year 1942

Net income	$18,886.90
Less: Personal exemption	600.00
Surtax net income	18,286.90
Less: Earned income credit (10% of 20% of $18,886.90)	377.74
Income subject to normal tax	$17,909.16
Normal tax at 6% on $17,909.16	$ 1,074.55
Surtax on $18,286.90	5,171.97
Income tax liability	$ 6,246.52
Income tax liability per return: Original, Account No. 114203, Los Angeles District	690.09
Statutory deficiency of income tax	$ 5,556.43
50% Penalty	$ 2,778.22
Statutory deficiency	$ 5,556.43
Add: (1) Unpaid original tax	345.04
Deficiency of income tax to be assessed	$ 5,901.47

(1) Under the Current Tax Payment Act of 1943, the unpaid income tax liability for the year 1942 was discharged as of September 15, 1943, and the two installments of 1942 tax paid was applied as payment of tax for the year 1943. Since the 50% penalty is asserted, the Current Tax Payment Act of 1943 is not applicable and the unpaid portion of the 1942 tax is to be reassessed.

Total tax on 1942 return		$690.09
Payments—3/15/1943	$172.53	
5/29/1943	172.52	345.05
Unpaid original tax to be reassessed		$345.04

Adjustment to Income
Year 1943

	Income Tax Net Income	Victory Tax Net Income
Net income per deficiency notice dated 1/17/1956	$ 87,031.39	$ 87,093.74
Addition—per amended answer: Overstatement of cash purchases	17,872.79	17,872.79
Net income as corrected—per amended answer	$104,904.18	$104,966.53

Computation of Tax
Year 1943

Income tax net income		$104,904.18
Less: Personal exemption		500.00
Balance subject to surtax		$104,404.18
Less: Earned income credit		1,400.00
Balance subject to normal tax		$103,004.18
Normal tax at 6% of $103,004.18		$ 6,180.25
Surtax on $104,404.18		62,619.30
Income tax		$ 68,799.55

Victory tax net income	$104,966.53	
Less: Specific exemption	624.00	
Income subject to victory tax	$104,342.53	
Victory tax before credit—		
5% of $104,342.53	$ 5,217.13	
Victory tax credit (25% of $5,217.13)	1,304.28	
Victory tax		3,912.85
Income and victory tax liability		$ 72,712.40
Income and victory tax liability per return, line 16:		
Original, Account No. NA 777786	$ 5,804.03	
Additional,		
Account 511064, 2-1947 List	13,994.87	19,798.90
Statutory deficiency of income and victory tax		$ 52,913.50
50% Penalty (computed below)		33,454.19
Total tax	$72,712.40	
Less—tax per return, line 16	5,804.03	
Deficiency for penalty computation	$66,908.37	
50% Penalty	$33,454.19	

(Forgiveness feature of the Current Tax Payment Act of 1943 is not applicable since 50% penalty is asserted)

Prepayment Credit Statement
Year 1943

	Per Return	As Adjusted
Total tax at line 16	$ 5,804.03	
Additional tax assessed	13,994.87	
Total Tax	$19,798.90	$ 72,712.40

Less:		
1942 tax paid	$ None*	
1943 estimated tax paid	2,868.23**	
1943 original tax paid	None**	
1943 additional tax paid	13,994.87	16,863.10
Deficiency of income and victory tax to be assessed		$ 55,849.30

*1942 tax paid is not allowable against 1943 tax.

**1943 estimated tax paid per District Director's records—Form 899.

(Return is not available to show payments as claimed on return.)

Adjustment to Income

	Year 1944	Year 1945
Net income per deficiency notice dated 1/17/1956	$ 81,350.64	$ 99,370.45
Addition—per amended answer:		
Overstatement of cash purchases	24,140.70	1,279.14
Net income as corrected—per amended answer	$105,491.34	$100,649.59

Computation of Tax

	Year 1944	Year 1945
Net income	$105,491.34	$100,649.59
Less: Surtax exemption	500.00	500.00
Surtax net income	$104,991.34	$100,149.59
Net income	$105,491.34	$100,649.59
Less: Normal tax exemption	500.00	500.00
Normal tax net income	$104,991.34	$100,149.59
Surtax	$ 71,762.29	$ 67,453.14
Normal tax at 3%	3,149.74	3,004.49
Income tax liability	$ 74,912.03	$ 70,457.63

Income tax liability per return:			
Original, Account No. 3061471, Los Angeles District	$17,455.87		
Additional, Account, 511065, 2/47L	3,730.83	$21,186.70	
Original, Account No. 3049966, Los Angeles District			$24,164.82
Statutory deficiency of income tax		$53,725.33	$46,292.81
50% Penalty		28,728.08*	23,146.41

*Computation of 1944 Penalty:

Total tax	$74,912.03
Less—tax per return	17,455.87
Deficiency for penalty computation	$57,456.16
50% Penalty	$28,728.08

Prepayment Credit Statement
Year 1944

	Per Return		As Adjusted	
Income tax liability	$17,455.87			
Additional tax assessed	3,730.83			
Total tax	$21,186.70			$74,912.03
Less:				
Estimated tax paid	$ 7,272.81		$ 3,636.41*	
Paid on return	10,183.06		10,183.06	
Additional tax paid	3,730.83	21,186.70	3,730.83	17,550.30
Deficiency of income tax to be assessed				$57,361.73

*Estimated tax paid per District Director's records—Form 899.

Adjustment to Income

	Year 1946	Year 1947
Net income per deficiency notice dated 1/17/1956	$101,948.51	$53,940.57
Addition—per amended answer:		
Overstatement of cash purchases	1,969.91	.....
Net income as corrected—per amended answer	$103,918.42	
Net income		$53,940.57

Computation of Tax

	Year 1946	Year 1947
Net income	$103,918.42	$53,940.57
Less: Exemption	500.00	500.00
Income subject to tax	$103,418.42	$53,440.57
Tax	$ 70,362.39	$29,400.43
Less: 5% reduction in tax	3,518.12	1,470.02
Income tax liability	$ 66,844.27	$27,930.41
Income tax liability per return:		
Original, Account No. 3200992, Los Angeles District	54,540.55	
Original, Account No. 9110055, Los Angeles District		10,716.30
Statutory deficiency of income tax	$ 12,303.72	$17,214.11
50% Penalty	$ 6,151.86	8,607.06

Prepayment Credit Statement
Year 1946

	Per Return		As Adjusted	
Income tax liability	$54,540.55		$66,844.27	
Less:				
Estimate tax paid	$45,000.00		$43,476.75*	
Paid on return	9,540.55	54,540.55	9,540.55	53,017.30
Deficiency of income tax to be assessed				$13,826.97

*Estimated tax paid per District Director's records—Form 899.

Received and Filed September 10, 1959, T.C.U.S.

Tax Court of the United States
Washington

Docket No. 61480

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed herein June 8, 1959, directing that decision be entered under Rule 50, the parties, on September 10, 1959, filed an agreed computation for entry of decision. It is therefore

Ordered and Decided: That there are deficiencies in income and victory tax and additions to tax as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

[Seal] /s/ ARNOLD RAUM,
Judge.

Entered: September 25, 1959.

Served September 29, 1959.

[Title of Tax Court and Cause.]

PETITION FOR REVIEW

Raymond J. Shorb, Administrator of the Estate of Walter F. Rau, Sr., Deceased, the Petitioner in this cause, by his counsel of record, hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered September 25, 1959, in Tax Court Docket No. 61480, ordering and deciding that there were deficiencies in income tax and additions thereto for the calendar years 1942 through 1947, inclusive, as follows:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b), I.R.C. 1939
1942	Income	$ 5,901.47	$ 2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,303.72	6,151.86
1947	Income	17,214.11	8,607.06

Nature of Controversy

The controversy involves the proper determination of Decedent's liabilities for Federal income taxes and the fraud penalty for each of the years 1942 through 1947, inclusive. The net worth of Petitioner's Decedent commencing with December 31, 1941, and ending as of December 31, 1947, was stipulated between Petitioner and Respondent at the hearing in the Court below. As of December 31, 1941, Decedent's net worth totaled $49,958.90, and, as of December 31, 1947, his net worth amounted to $234,149.88.

In lieu of the net worth, as thus stipulated between the parties, the Court below predicated its determination of Decedent's liabilities for Federal income taxes, for each of the years involved, upon the oral testimony of two former employees. As a result thereof, the Court below determined deficiencies in the amount of $188,350.94 and imposed the fraud penalty provided for in Section 293(b), Internal Revenue Code, 1939, in the sum of $102,865.82 for the years 1942 through 1947, inclusive.

The controversy, therefore, involves the propriety of the action of the Court below in rejecting the net worth method, and the validity of its determination resulting from such action.

Assignments of Error

The Petitioner assigns as error the following acts of the Tax Court of the United States:

1. The Tax Court erred in deciding that the Petitioner on Review was liable for the fifty (50%) per cent fraud penalty (Section 293(b) I. R. C. 1939) for each of the years involved herein.

2. The Tax Court erred in deciding that the statute of limitations was not a bar to the assessment and collection of taxes for the years 1942 through 1944, inclusive.

3. The Tax Court erred in that its decision is not supported by the evidence and is contrary to law.

4. The Tax Court erred in rejecting the net worth method, and, by substituting therefor, the uncorroborated testimony of two employees in determining the income tax liabilities of the Decedent for each of the years in question.

5. The Tax Court erred in admitting, in evidence, the testimony of a surviving partner against a deceased partner.

6. The Tax Court erred in compelling Petitioner to produce its books and records in support of Respondent's allegation of fraud against the Decedent.

7. The Tax Court erred in that its decision is arbitrary.

8. The Petitioners, being aggrieved by the Memorandum Findings of Fact and Opinion of the Tax Court promulgated June 8, 1959, and by the decision of the Tax Court of the United States entered pursuant thereto on September 25, 1959, seek a review thereof by the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted.

/s/ ELLSWORTH T. SIMPSON,
Attorney for Petitioner on Review.

Affidavit of Mail attached.

Filed December 23, 1959, T.C.U.S.

[Title of Tax Court and Cause.]

MOTION TO ENLARGE TIME

Comes now the Petitioner, to the above-entitled proceeding, by his counsel of record, and moves:

That the time for the preparation of evidence, transmission and delivery of the record on review be extended for a period of fifty (50) days, or until March 22, 1960, and, as grounds therefor, counsel for Petitioner states that the voluminous record containing numerous exhibits is the proper subject for stipulation between the parties that additional time will be required for the purpose of negotiations between the parties for this purpose.

Counsel for Petitioner further states that he is presently engaged in trial of cases requiring his immediate attention.

Wherefore, the premises considered, the Petitioner prays the allowance of the within Motion.

/s/ ELLSWORTH T. SIMPSON,
Attorney for Petitioner.

Filed December 30, 1959, T.C.U.S.

[Title of Tax Court and Cause.]

ORDER ENLARGING TIME

On motion of counsel for petitioner on review, it is

Ordered: That the time for filing the record on review and docketing the petition for review in the United States Court of Appeals for the Ninth Circuit is extended to March 22, 1960.

[Seal] /s/ J. E. MURDOCK,
Judge.

Dated: Washington, D. C., December 31, 1959.

Served: December 31, 1959.

The Tax Court of the United States

Docket No. 61480

In the Matter of:

Estate of WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Before: The Honorable Arnold Raum.

TRANSCRIPT OF PROCEEDINGS

Thursday, June 26, 1958

The above-entitled matter came on for hearing pursuant to a notice, at 10:00 o'clock a.m.

Appearances:

MR. J. EARL GARDNER and
MR. JOHN SCHESSLER,
Appearing on Behalf of the Respondent.

MR. E. T. SIMPSON,
Appearing for Petitioner.

* * *

ROBERT R. WEBB

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows: [27*]

* * *

The Clerk: Spell your last name.

The Witness: W-e-b-b.

The Clerk: Your address, please.

The Witness: 2311 21st Street, Bakersfield, California.

The Clerk: Thank you.

Direct Examination

By Mr. Gardner:

Q. Now, Mr. Webb, did you know Walter F. Rau, Sr.? A. Yes, sir.

Q. When did you first meet Mr. Rau?

A. 1932.

Q. What were the circumstances at that meeting, sir?

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of Robert R. Webb.)

A. Well, he hired me to work as a clerk in the Southern Hotel.

Q. I am sorry, I didn't get that.

A. He hired me to work as clerk in the Southern Hotel.

Q. At the Southern Hotel? A. Yes, sir.

Q. You were the clerk at the Southern Hotel?

A. Yes, sir.

Q. You were an employee? A. Yes, sir.

Q. Now, how long did you work at the Southern Hotel [30] as a clerk?

A. Was there from 1932 until 1947, my total employment there.

Q. Why did you leave in 1947?

A. The Southern Hotel building was demolished.

Q. Now, in between that time, 1932 to 1947, did you take on any other duties?

A. Well, he appointed me as manager. I still worked as a clerk most of the time, but I had the title as a manager.

Q. Manager of what, sir?

A. Of the Southern Hotel.

Q. And as manager of the Southern Hotel, did you take charge of any other activities located in the hotel?

A. I handled the cash from the French Cafe when it was brought to me by the cashier, and the Southern Wine and Liquor Store of the Southern Bar, I handled, took off receipts every day.

Q. That is, they made an accounting to you; is that correct, Mr. Webb? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. And did you record the receipts in any form, in any book?

A. I recorded in a day book that we had; yes, sir.

Q. In a day book. [31]

Now, moving on up to the year 1941, were you employed by Mr. Rau at that time, 1941, as manager of the hotel and also in charge of the cash receipts of the French Cafe, and the Southern Wine and Liquor Store? A. Yes, sir.

Q. Now, did business go along at an even keel, Mr. Webb, from 1941, 1942——

Mr. Simpson: Objection, calls for a conclusion from the witness.

The Court: I think it is much too general.

Mr. Gardner: Very well, your Honor, I will rephrase that question.

Q. (By Mr. Gardner): Can you recall the approximate receipts of the French Cafe during the year 1939, 1940?

Mr. Simpson: That is objectionable; that is a very general question, calls for an approximation, and a guess from this witness.

The Court: All right. Will the reporter read the question?

(Question read.)

The Court: That can be answered yes or no, and the question may be answered.

The Witness: Well, the approximate receipts——

The Court: You are not being asked what

(Testimony of Robert R. Webb.)

the [32] receipts were; you were asked whether you can recall the approximate receipts. Can you recall them?

The Witness: No, sir.

Mr. Gardner: Very well.

Q. (By Mr. Gardner): Mr. Webb, did the manner in which you received the receipts of the French Cafe, the Southern Wine and Liquor Store, did that vary in any way from the year that you started receiving those receipts, up to the year 1942?

Mr. Simpson: I dislike very much to the continuous objection in this manner, but this question is objectionable for the same reason.

Mr. Gardner: If the Court please——

The Court: I suppose a man that is in charge of recording the receipts of a business should have a pretty reliable recollection as to whether or not the receipts followed a fairly steady pattern, or whether they followed an irregular pattern, and I would permit him so to testify.

Mr. Simpson: Well, it seems to me that he is asking for a recollection of some 18 years ago. Now, without exhibiting anything to him, to refresh his recollection, he is asking for a general statement with respect to whether or not receipts from a business 18 years ago varied.

The Court: That would go to the weight of the [33] evidence, rather than its admissibility.

The witness may answer.

The Witness: The receipts from 1942, latter part of 1941, when the war was declared, up until

(Testimony of Robert R. Webb.)

1945, you want to know the approximate—how much?

Q. (By Mr. Gardner): No. Would you——

A. After 1945, the receipts dropped down a little bit.

Mr. Simpson: Do I understand your testimony, to get it clear, the receipts dropped down, did you say, Mr. Webb?

The Witness: A little bit as the war was over.

Q. (By Mr. Gardner): Did the receipts increase during the war?

A. Increased during the war; yes, sir.

Q. Were there any Army camps located around Bakersfield?

A. There was one camp, Camp Minor, was right on the outskirts of Bakersfield, and also an Army camp in Taft, about 40 miles from Bakersfield.

Q. You were a resident of Bakersfield prior to the war, weren't you, Mr. Webb? A. Yes, sir.

Q. Did you notice whether or not these streets were [34] crowded with soldiers?

A. Yes, it was.

Q. After these camps opened.

And when did these camps open, Mr. Webb, approximately?

A. Well, Camp Minor opened about 1940, '41.

Q. And the other camp, sir?

A. I am not sure about Camp Gardner, that was a little bit later.

Q. Would you say it was prior to 1942?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Mr. Gardner: I would like to have this marked for identification as respondent's next in order.

The Clerk: Respondent's Exhibit M.

(The document above referred to was marked Respondent's Exhibit M for identification.)

Mr. Simpson: If your Honor please, before I can make an intelligent objection to this evidence—I see here is a group, I don't know how many, of photostats of something that I do not know what they represent. They are merely figures on paper.

Mr. Gardner: If the Court please, I have not yet offered it in evidence.

Mr. Simpson: He has identified it, and he wants to offer it. He has handed it to me before he has offered it. [35]

The Court: You make your objection when he offers it. There is no need to make any anticipatory objection at this time.

Mr. Simpson: All right.

Q. (By Mr. Gardner): Mr. Webb, I hand you what has been marked for identification as Respondent's Exhibit M, and turning to a sheet immediately under tab S-13 thereof, show you a sheet and ask you if you recognize the writing on that?

A. The $210, the $415.62 are my writing.

Mr. Simpson: Just a minute.

If your Honor please, he is asking him if he recognizes writing. I see a lot of writing on that sheet. He just referred to—I wish counsel for re-

(Testimony of Robert R. Webb.)

spondent would direct his attention to what particular writing that he wants him to identify.

Mr. Gardner: If you will read the question, please, that I gave, Mr. Reporter.

(Question read.)

The Witness: I can recognize the $210 as my writing, and $415.62 as my writing.

The Court: Those are the last two figures on that sheet?

The Witness: Yes, sir.

Mr. Gardner: May I continue? [36]

Mr. Simpson: Now, your Honor, maybe I can make my objection.

On this particular sheet just identified, under tab S-13, is it, the witness has identified only one figure. They contain others. In order to make my objection, I would like to find out first of all, if any other writing in that, on that tab 13, S-13, is in the handwriting of this witness?

The Witness: No, sir.

Mr. Simpson: I object on the grounds that this witness is not competent to testify with respect to the entries appearing on this sheet identified as S-13.

The Court: Objection is overruled.

Q. (By Mr. Gardner): Mr. Webb, I believe that you testified that you did recognize the figure $210 and $415.62; is that correct? A. Yes, sir.

Q. Could you tell us just what those figures represent?

A. The total receipts for that day was $625.62.

(Testimony of Robert R. Webb.)

$10 a day was taken off every day, and the $200 was taken off for—well, off the top.

Mr. Simpson: If your Honor please, I have a problem here, once again. I must insist on it.

He is testifying with respect to some figures he did not keep or write, but he is testifying with respect [37] to some figures at the bottom.

Now, they are all part of this sheet, and unless he is competent to testify with respect to these entries up here, I must object again on the grounds that this testimony which the Government seeks to elicit from this witness is not admissible, for the reason that this witness is not competent to testify as to what these figures represent here, only those at the bottom.

The Court: I will let the witness' answer stand.

Mr. Gardner: Could we have the witness' answer again, please, Mr. reporter.

(Record read.)

Q. (By Mr. Gardner): Now, you have stated that this shows the $210 was taken off, well off the top, off the top of what, Mr. Webb?

A. Off the top of the total receipts for the day.

Q. All right. Now——

The Court: Receipts from what?

The Witness: From the French Cafe.

Q. (By Mr. Gardner): Does this document represent the total receipts of the French Cafe, Mr. Webb, for the day February 6? A. Yes, sir. [38]

(Testimony of Robert R. Webb.)

Q. I am not putting words in this witness' mouth.

Mr. Simpson: Yes, yes, you are putting words in his mouth, that they represented receipts. I do not yet know through this witness whether or not these figures up here—he can testify as to whether or not they are receipts, or what they are.

Mr. Gardner: All right. May I continue to tie that in?

Mr. Simpson: He has already so testified.

Q. (By Mr. Gardner): I believe you testified, Mr. Webb, that you did receive the, as manager of the Southern Hotel, you did have charge of the receipts of the French Cafe, did you not, sir?

A. Yes, sir.

Q. And how did you receive the information relating to the receipts of the French Cafe for any particular day?

A. The steward or the cashier from the French Cafe would bring me out this copy, and also the——

Q. This copy, now you are referring there, sir, to——

A. These figures here. Also the tape for the French Cafe.

Q. You are referring now to S-13 of Respondent's Exhibit M for identification?

A. Yes, sir. [39]

Q. And on that slip, would you point out where the receipts for the day would be shown, sir, that is the——

A. On the top.

(Testimony of Robert R. Webb.)

Q. All right. Would you state for the record, please, sir, state. A. On the top line.

Q. All right, sir. And how much is that?

A. Reading 62982.

Q. Reading, what does it mean by reading?

A. That was a reading on the cashier's tape that she would bring out every morning for me, with the cash of the day's receipts.

Q. Very good, sir.

And who put that writing here, that is this amount shown on this exhibit, sheet S-13 of Exhibit M?

A. That would be the steward, or the cashier in charge of the coffee shop, French Cafe.

Q. And at the same time, would they give you the money, the cash?

A. They would give me the money; yes, sir.

Q. And as you have stated now, you took $210 out of what? A. Out of the total receipts.

Q. Out of the total receipts.

Now, what did you do with that $210, Mr. Webb? [40]

A. $10 I put in an envelope, one envelope; the $200 I put in another envelope.

Q. What did you do with the envelopes?

A. They were put in the safe in the office.

Q. Did you put any marking on the envelopes?

A. I would put on the marking of the $10 a day, at the end of the month, I would have $300 or $310, whichever the number of the days of the month.

Q. In other words, you took out $10 every day of the month? A. Every day, yes, sir.

(Testimony of Robert R. Webb.)

Q. And you put that in an envelope?

A. Yes, sir.

Q. And you put it in the safe? A. Yes, sir.

Q. Now then, can you state of your own knowledge, as to who got that money, sir?

A. Mr. Walter Rau, Sr.

Q. Mr. Walter Rau, Sr.

Now, what happened to the $200 here?

You stated that of this $210, you put $10 in one envelope. Now, what did you do with the $200?

A. Well, usually at the end of the month, or could be any time of the month, for that matter, he would put it in his personal account, or possibly in the safe deposit box [41] at the Anglo Bank.

Q. Let's step back just a step.

You now have the receipts in your hand, and I believe you testified that you took $10 off the top and put it in one envelope. Now, you have $200 here that you also stated you took off the top. What did you do with that?

A. It was put in another envelope.

Q. In another envelope, sir? A. Yes.

Q. Now, what does this date indicate here, that is February 6; is that correct, sir?

Do you know whether or not that was a week end? A. No, sir.

Q. Do you know whether or not you were instructed before I—do not answer that question.

Why did you take $200 and $10 off the top?

A. Usually, the week end, we would do more business on a Saturday and Sunday than a weekday.

(Testimony of Robert R. Webb.)

Q. Well——

A. Or holiday, maybe.

Q. Who, if anyone, instructed you to take this money and place it in an envelope, sir?

A. Mr. Rau.

Mr. Simpson: Objection.

The Court: Overruled. [42]

Q. (By Mr. Gardner): You may answer the question, sir. A. Mr. Rau, sir.

Q. Mr. Rau instructed you? A. Yes, sir.

Q. And did he tell you, what did he tell you?

A. Well, of course, he told me about the $10 a day to take out $10 a day, every day. And he would usually tell me about how much to take off on—depended upon the total receipts, whether it was $100, usually a hundred dollars on a Saturday or a hundred dollars on a Sunday.

Q. And you would take that off then?

A. Yes, sir.

Q. Now——

The Court: Were these general instructions, or did he give them to you for each day?

The Witness: Well, when he was there, it would be for each day.

Q. (By Mr. Gardner): Was it your understanding that you had to inquire of him every day as to—— A. No.

Q. What was your understanding, sir?

A. I was, would show him the total receipts. I would give him the tapes and tickets at the bar, the

(Testimony of Robert R. Webb.)

receipts [43] tape, then, well, say, well, he will take off $100 or $150, usually it was $100.

The Court: He would tell you that?

The Witness: Yes, sir.

The Court: Were these receipts for the preceding day?

The Witness: Yes, sir.

The Court: All right.

The Witness: I would get the receipts in the morning.

Q. (By Mr. Gardner): Let's go specifically to this item of $10, Mr. Webb. I believe you testified that that came off every day; is that correct, sir?

A. Yes, sir.

Q. Now, you didn't have to talk with Mr. Rau about that every day, did you? A. No, sir.

Q. Why, what were your instructions in that connection?

A. At the end of the month, if it was a 30-day month, he would have $300, and he would take that and maybe deposit it in his own account, or in a safe deposit box, or he let it accumulate for awhile.

Q. Any event, it was turned over to Mr. Rau at the rate of $10 a day? [44] A. Yes, sir.

Q. You did have discussions with him regarding these larger amounts; that is the $200 on the week ends; is that correct, sir? A. Yes, sir.

Q. Now, this relates to the French Cafe does it not, sir? A. Yes, sir.

Q. Now——

The Court: Has the date of this particular sheet

(Testimony of Robert R. Webb.)

been established? I notice February 6 is on it, but has the year been established?

Mr. Gardner: I thought I did have that, if the Court please. February 6. I intended to tie that up all the way through, your Honor, by going through these various records.

The Court: All right.

Mr. Gardner: Well, might as well do that right now.

Mr. Simpson: You go ahead and make your offer. I will make my objection.

Mr. Gardner: Is that right? All right.

Mr. Simpson: I will make my objection; you make your offer.

Mr. Gardner: I would like to have this [45] book—it is a yearbook, 1938, with that crossed out, and in pencil, 1944 written on the front, just barely discernible, marked as respondent's next in order, please.

The Clerk: Respondent's Exhibit N marked for identification.

(The document above referred to was marked Respondent's Exhibit N for identification.)

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): Referring to Respondent's Exhibit N for identification, and turning to the page showing thereon Sunday, February 6, 1938, could you tell me, sir, whether or not there is any writing on that page that you recognize?

A. All writing on the page is my writing.

(Testimony of Robert R. Webb.)

Q. And do you see on there a figure, under the item "Cafe"? A. Yes, sir.

Q. What is the figure shown there, sir?

A. $415.62.

Q. Does that correspond, sir, with the amount shown in—— A. Yes, sir.

Q. ——Exhibit M? A. Yes, it does, sir.

Q. Under S-13? [46] A. Yes, sir.

Q. Did you put this figure in here, sir?

A. Yes, sir.

Q. And where did you get the information for that figure?

A. It was brought in to me from the French Cafe; this information was given to the bookkeeper.

Q. This is the information that you gave to the bookkeeper? A. Yes.

Q. What was this supposed to reflect, Mr. Webb?

A. Total receipts for the day.

Q. Total receipts for the day.

Now, actually, did that reflect the correct total receipts for the day, sir? A. No, it didn't.

Q. It was understated in what amount, sir, if any? A. At least $210.

Q. At least $210.

Now, if the Court please, this book, that is Respondent's Exhibit N, has marked thereon 44 on the outside. We have other yearbooks for every year except '44. That is 1942, '43, '45, '46, '47, and we believe that this book does represent the yearbook for the year '44.

(Testimony of Robert R. Webb.)

At this time, I would like to offer in evidence [47] Respondent's Exhibit N.

Mr. Simpson: If your Honor please, this is one of the records that I objected to this morning as an aid in assistance to the Respondent in meeting its burden of proof; inasmuch as we had stipulated the deficiency and the burden as to proof, that is the only remaining issue, actually, upon the respondent to——

Mr. Gardner: This is about the third time. I don't like to—I have stated to a deficiency. I have done no such thing.

The Court: Let him continue his objection, Mr. Gardner.

Mr. Gardner: Yes, sir.

Mr. Simpson: But as to this evidence that they seek now to introduce against a deceased person, I would like to make the objection for the reason that there is no opportunity for the petitioner to cross-examine actually as to what this witness is saying, that the deceased told him as to what entries he should make.

For that reason, I object to the introduction of this evidence.

The Court: Were the remaining entries in this book likewise made by you, Mr. Webb?

The Witness: Yes, sir. Unless it happened to be a day that I was off sick or something. [48]

The Court: But as you go over the pages, do the entries in general appear to be in the—the entries in your handwriting?

(Testimony of Robert R. Webb.)

The Witness: Most of them are in my handwriting; yes, sir.

The Court: And was each entry handled in a manner similar to the entry of February 6?

The Witness: Yes, sir.

The Court: Did each of them reflect a reduced amount from the actual receipts based upon instructions given to you?

The Witness: Yes, sir.

The Court: By Mr. Rau, Sr.?

The Witness: Yes, sir.

The Court: I will admit Exhibit N.

(The document above referred to, previously marked Respondent's Exhibit N for identification, was received in evidence.)

Q. (By Mr. Gardner): Mr. Webb, I direct your attention to Respondent's Exhibit M, the sheet under S-9.

The Court: Before you do that, Mr. Gardner, may I see Exhibit N again, please, Mr. Clerk.

The Government attorney stated that he believed that this did represent data for the year 1944. Is there [49] anything about this book which would confirm to you that these entries did reflect, did refer to 1944, and not to some other year?

Can you testify as to what year these entries are concerned with?

Mr. Gardner: I believe I can tie it up later on, your Honor.

The Court: I will permit you to do so.

(Testimony of Robert R. Webb.)

Mr. Gardner: I believe I can tie it right into the ledger.

The Witness: This is my writing here, but in 1944 is not my writing. The 1944 is not my writing.

Mr. Gardner: All right. I will try to tie it up later on.

Mr. Simpson: If your Honor please, can I have this witness answer all questions as to whether or not he can identify the writing, or whether or not he can identify the year in that Respondent's Exhibit N? I think it is, isn't it?

The Clerk: Yes.

Mr. Simpson: Can you have him answer that question?

The Court: Would you answer that, please, Mr. Webb?

The Witness: I can't identify that as 1944. [50]

Mr. Simpson: Thank you.

Mr. Gardner: Very well.

Q. (By Mr. Gardner): Now, referring once again, Mr. Webb, to Exhibit M, under S-9, would you look at that sheet and see if there is any writing on there that is your handwriting, sir?

A. Yes, sir. $110 and $447.08 are my writing.

Q. Would you describe what this document is, sir?

A. That is a cash pay-out of the French Cafe.

Q. For what date, sir?

A. October 9, 1943.

Q. And where did you get that information, sir?

(Testimony of Robert R. Webb.)

A. Got that from the steward or the cashier of the French Cafe.

Q. What is the net amount shown?

A. The net amount is $447.08.

Mr. Gardner: I would like to have this marked as Respondent's next in order for identification.

The Clerk: Respondent's Exhibit O.

(The document above referred to was marked Respondent's Exhibit O for identification.)

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): I hand you what has been marked Respondent's Exhibit O for identification, and turn to the date, Saturday, [51] October 9.

A. Yes, sir.

Q. Is your handwriting on that page, sir?

A. Yes, sir.

Q. Would you examine the book and see if your handwriting is throughout the page, throughout the book in general?

A. Well, this item here is not in my handwriting.

Q. What item is that?

A. Sunday, January 31.

Q. All right. Keep going. A. That is not.

Q. You are referring also to Sunday, January 31; is that correct, sir, of Exhibit O?

A. January 1, 2, Saturday, February 27, and Sunday, February 28.

Q. Are not your writing?

(Testimony of Robert R. Webb.)

A. Are not my writing.

The Court: All other entries up to that point in your handwriting?

The Witness: Yes, sir.

Q. (By Mr. Gardner): All right. Would you just give it a look through here in general?

A. Okay. [52]

Q. And see whether or not most of the items in there are in your handwriting.

A. Saturday, March 27; Sunday, March 28; for the bar, is not in my handwriting. Cafe is.

Q. All right, sir.

A. Wait a minute; wait a minute.

The Court: And were all the other entries up to that point between February and March——

The Witness: I am not positive about this. This is mine or not.

The Court: Were all the other entries?

The Witness: Yes, sir.

The Court: Were all the other entries up to that point in your handwriting?

The Witness: Yes, sir. Let's see, these are all my handwriting.

Q. (By Mr. Gardner): I don't think it is too important whether all of them are in your handwriting, Mr. Webb. If you would just look there and see if most of them are in your handwriting, sir.

Would you describe what that book is, sir?

A. That book was given to the bookkeeper as

(Testimony of Robert R. Webb.)

the actual deposit made for the French Cafe and the Southern Bar. [53]

The Court: The actual what?

The Witness: Deposit, bank deposit.

The Court: I don't understand what that means. Do you mean receipts?

The Witness: Yes, sir.

Mr. Gardner: Maybe I can clear that up, your Honor.

Q. (By Mr. Gardner): The amount shown here on Exhibit M, under S-9, of $447.08, is that the amount that you show over here also in Respondent's Exhibit O? A. Yes, sir.

Q. And is that the amount that represented the receipts for the day? A. Yes, sir.

Q. And what did you do with those receipts, sir?

A. I deposited them in the Bank of America.

Q. In other words, the daily receipts equalled the daily deposit, didn't they? A. Yes, sir.

Q. Now then——

The Court: Were those the actual receipts?

The Witness: No, sir.

Q. (By Mr. Gardner): Would you state what the actual receipts were, [54] sir, from Exhibit M, S-9? A. The actual receipts were $763.89.

Q. From that you took off what, sir?

A. Well, I took off $110.

The Court: You, if you take off $110, you would get only $662.89. Will you explain how you got from $762.89 down to $447.08?

The Witness: The total reading, the reading of

(Testimony of Robert R. Webb.)

the Coffee Shop was $763.89. There was a paid-out, cash pay-out of $198.31, which left a balance——

The Court: What does that mean, what does a cash paid-out mean?

The Witness: Well, it was paid out for groceries that were delivered at the Coffee Shop, by the cashier.

The Court: And by Coffee Shop, you mean French Cafe?

The Witness: Yes, sir. The actual cash that I received was $557.08.

The Court: There seems to be a $7.50 item there, as well; what is that?

The Witness: That is tickets. I don't know what that is. The $557.08 is the money that I received from the steward, and I took $110 off of that, which left a balance of $447.08.

The Court: Okay. [55]

Q. (By Mr. Gardner): Did you have meal tickets at the French Cafe, Mr. Webb, do you recall?

A. For a short time. I don't remember just what the year was.

Q. I notice the item there, $7.50, has the notation "tickets" for identification; could that be meal tickets?

A. It could be meal tickets, but I am not, I couldn't say that was in 1943.

Q. I see. All right, sir.

Now, you stated that Respondent's Exhibit O was the record that you gave to the bookkeeper; is that correct, sir? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. And that was the record maintained by her to show the income of the French Cafe; is that correct, sir? A. Yes, sir.

Q. Now, before we go any farther, I would like to ask you whether or not the Southern California, or the Southern Wine and Liquor Store operated in the same manner; that is, as to giving you these receipts and whether or not you made deposits for that business venture?

A. The Southern Wine and Liquor Company, I took receipts off, myself.

Q. You took those receipts off, yourself? [56]

A. Yes, sir.

Q. Now, referring to the year 1942——

The Court: What do you mean by you took those receipts off, yourself?

The Witness: I took the receipts off at four o'clock in the afternoon. I would go in on the four o'clock shift.

The Court: You mean——

The Witness: Check the bartender at four o'clock.

The Court: And take the tapes and the cash?

The Witness: No.

The Court: Would you explain exactly what you did?

The Witness: I would take a reading at four o'clock from the bartender, checked out, to check his cash out. The night bartender would take a reading at 12:00 o'clock, or two o'clock, depending upon what time the bar closed, and in the morning, I

(Testimony of Robert R. Webb.)

would go in and get the total receipts for the tape, for both bartenders. There would be an A drawer and a B drawer.

The Court: Each bartender has his own drawer?

The Witness: Yes, sir.

Q. (By Mr. Gardner): What would you do with these receipts? I am referring now to the year 1942?

A. Well, I would take an ordinary piece of paper, A [57] drawer so much, B drawer so much. Sometimes we might have three bartenders, and total.

I would get the tapes, the tape for the bar, and also the ticket at the cash register, the total amount cash. I would wait for Mr. Rau to come down; if he didn't come down that morning, I would take them to his room and I would take $25 a day off Southern Wine and Liquor Company.

Q. Would you state that figure again, Mr. Webb? A. $25 a day.

Q. This is all, this was during the year 1942, sir?

A. It was 1942, maybe a little prior to 1942, until, probably, up until 1947.

Q. Every day you would take off $25 a day?

A. $25, yes, sir.

Q. Now, what did you do with that $25, sir?

A. That would be put in a separate envelope, marked "bar."

Q. And what receipt or what figure would you give the bookkeeper for the receipts for that day?

(Testimony of Robert R. Webb.)

A. Well, if it was nothing else taken off that day, it would be minus the $25.

The Court: You mean the actual receipts minus $25? A. Yes, sir. [58]

Q. (By Mr. Gardner): Give her the figure of the actual receipts less $25, so that the figure given to the bookkeeper was $25 lesser than the actual receipts? A. Yes, sir.

Q. Is that correct, sir? A. Yes, sir.

Q. Now, I believe you stated that that happened every day? A. Yes, sir.

Q. Did any change in this practice occur on week ends, or holidays?

A. Well, week ends, it was usually $100 on a Saturday, maybe $100 on a Sunday, and it could be $150.

Q. Now, are you saying that the receipts were reduced by $100 or $150 or $200 on a week end?

A. Yes, sir.

Q. And that these amounts were not recorded in the books as income? A. Yes, sir.

Mr. Simpson: I object. I don't believe he knows whether it was recorded as income in the books. He said it was a bookkeeper he gave the receipts to. I object.

The Court: Sustained.

Mr. Simpson: And move that his answer be stricken. [59]

Q. (By Mr. Gardner): In any event, the figure that you gave to the bookkeeper was understated by the amounts of $100 to $150, or $200 on week ends;

(Testimony of Robert R. Webb.)

is that correct, sir? A. Yes, sir.

Q. And they were——

The Court: Is that for each day on week ends, or just——

Mr. Gardner: No, this is——

The Court: Or are you speaking for the, about the total week end?

The Witness: The $25 was every day, $25 a day for seven days a week.

The Court: Now, what days are you referring to when you speak about week ends?

The Witness: Saturday and Sunday.

Q. (By Mr. Gardner): How much would be taken off Saturday?

A. Well, depended, usually $100.

Q. How high did it go?

A. Well, it was an exceptionally big day, it might be $200, $150, $200.

Q. And on Sunday, how much would be taken off? A. The same deal.

Q. How much would be taken off on a holiday, if any? [60]

A. It depended on how much business, how good business was that day.

The Court: Who would decide how much was to be taken off?

The Witness: Mr. Rau.

The Court: You would receive your instructions from him?

The Witness: I would receive it from him when he was in the building, when he was in town. If he

(Testimony of Robert R. Webb.)

happened to be down at the Hot Springs for a couple days, then I would take it off, $100, myself, but I would save the tape for him and the——

Q. (By Mr. Gardner): But he examined the tape? A. Yes, sir.

Q. When he returned? A. Oh, yes.

Q. Now, as to the $25 a day, would you state whether or not you had standing instructions to remove that? A. I did.

Q. Who gave you these instructions, sir?

A. Mr. Walter Rau.

Q. And he told you exactly how to do it?

A. Yes, sir.

Q. Now, that held true throughout the year 1942, I believe [61] you stated; is that correct, sir?

A. Yes, sir.

Q. Did the same practice continue through 1943?

A. Yes, sir.

Q. Did the same practice continue through 1944?

A. Yes, sir.

Q. And we are speaking now of the Southern Wine and Liquor Store? A. Yes, sir.

Q. The same practice continue through the year 1945? A. Yes, sir.

Q. And did the same practice continue through the year 1946?

A. Yes, sir, and in the Southern Bar.

Q. That is what we are referring to now, is only the Southern Wine and Liquor Store, that you sometimes speak of as the Southern Bar.

Now, did it also continue in 1947, up to the time

(Testimony of Robert R. Webb.)

that the Southern Wine and Liquor Store was closed, about August 7, 1947?

A. Well, I am not positive of the last few days, or the last week or two.

Q. Would you say it continued in January of 1947? A. Yes, sir. [62]

Q. February? A. Yes, sir.

Q. March? A. Yes, sir.

Q. April? A. Yes, sir.

Q. May? A. Yes, sir.

Q. June? A. Yes, sir.

Q. July? A. Yes, sir.

Q. In other words, you would say that the same practice of taking off the top every day $25, and $100 to $200?

A. May not have taken it off the last few days. I think the building was demolished August 7, something like that, 1947.

Q. I see. But at least, during six months of that year, he did—I mean, you did? A. Yes, sir.

Q. Take off these amounts? A. Yes, sir.

Q. As you were instructed to do, and who, once again, instructed you to do this? [63]

A. Mr. Walter Rau.

Q. All right, sir. Now, going——

The Court: Off the record.

(Discussion off the record.)

The Court: There will be a short recess.

(Short recess.)

(Testimony of Robert R. Webb.)

Mr. Gardner: At this time, Respondent would like to offer in evidence Exhibit O.

The Court: Admitted.

(The document previously marked as Repondent's Exhibit O was received in evidence.)

Q. (By Mr. Gardner): Referring once again to Respondent's Exhibit M for identification, to the sheet under S-41, would you look at that sheet and see if you recognize any of the writing thereon?

A. I recognize receipts, $401.23, paid out.

The Court: Is that at the bottom of the page?

The Witness: Yes, sir.

Paid out $105.67, $295.57, $10 off leaves $285.57, and $286.

Q. (By Mr. Gradner): Now, would you refer, sir——

I would like to have this marked as Respondent's next [64] in order for identification, please.

The Clerk: Respondent's Exhibit P.

(The document above referred to was marked Respondent's Exhibit P for identification.)

Q. (By Mr. Gardner): I would like you to refer to Respondent's Exhibit P for identification, under date of August 7, and ask if you recognize the handwriting on that page, sir? A. I do.

Q. And what is the amount shown thereon?

The Court: Whose handwriting is it?

The Witness: That is my handwriting, 286.

Q. (By Mr. Gardner): Referring once again to

(Testimony of Robert R. Webb.)

Exhibit M, S-41, the $286 shown on that page, is that where you got the information to put in Exhibit P? A. Yes, sir.

Q. And what is this sheet that we have just been referring to, in Exhibit M, under S-41?

A. That is a cash sheet from the French Cafe.

Q. That is the cash sheet from the French Cafe, and those computations that you were identifying were your computations on the bottom of the page; is that correct, sir? A. Yes, sir. [65]

Q. And that is where you got the information that you put in this book, Exhibit P; is that correct, sir? A. Yes, sir.

Q. Would you state what this book is, this Exhibit P?

A. This book is the actual deposits that were made, and actual amounts that were given to the bookkeeper to—for her records.

Q. The $286 shown there, for the date August 7, is that the total receipts reported for that day, sir, from the French Cafe?

A. That is the total receipts that were deposited. It is not the total receipts; the total receipts were $401.23.

Q. But the total receipts that were given to the bookkeeper were how much, sir? A. $286.

Q. Now, would you examine this book, other entries in here, and state whether or not your writing appears throughout that book? That is Exhibit P.

(Testimony of Robert R. Webb.)

A. This is not. With the exception, about three or four days, it is all my writing.

Q. Now, Mr. Webb, when you didn't take care of this book, who did? That is Exhibit P.

A. Miss Goldstein.

Q. Miss Goldstein took care of that. And did she, did you instruct her as to whether or not to take off receipts? [66]

A. I probably instructed her about the $10 a day for the French Cafe, and $25 a day for the Southern Wine and Liquor Company.

The Court: Who is Miss Goldstein?

The Witness: Our bookkeeper.

Q. (By Mr. Gardner): The bookkeeper that you had at the—for the French Cafe and for the Southern Wine and Liquor Store?

A. And the Southern Hotel.

Q. And the Southern Hotel. Her name was, again?

A. Her name was Miss Goldstein, Mrs. Longway, her maiden name.

Q. Now, she was the one to whom you gave the information regarding the receipts for each day; is that correct, sir? A. Yes, sir.

Q. And she would take care of these books in your absence, that is Exhibit P?

A. Yes, sir.

Q. And did that apply to the year 1942, also, sir?

A. Yes, sir.

Q. Year 1943? A. Yes, sir.

Q. 1944? A. Yes, sir. [67]

(Testimony of Robert R. Webb.)

Q. The year 1945? A. Yes, sir.

Q. The year 1946? A. Yes, sir.

Q. And the year 1947? A. Yes, sir.

Mr. Gardner: At this time, I offer in evidence Respondent's Exhibit P.

The Court: Admitted.

(The document previously marked Respondent's Exhibit P was received in evidence.)

Mr. Gardner: Could I have that marked for identification as Respondent's next in order.

The Clerk: Respondent's Exhibit Q.

(The document above referred to was marked Respondent's Exhibit Q for identification.)

Q. (By Mr. Gardner): Referring once again to Respondent's Exhibit M for identification, under the sheet of S-59, would you examine that sheet and state whether or not any of the writing on that sheet is yours?

A. At the bottom of the page, receipts $546.14, paid out $53.43; $492.71; $100 off, $392.71.

Q. Now, would you state what that document is, sir?

A. That is cash sheet from the French Cafe, on [68] Sunday, February 17, 1946.

Q. I hand you what has been marked Respondent's Exhibit Q for identification, referring to the sheet therein showing the date February 17, Sunday, and ask you if you recognize the handwriting on that sheet as your handwriting? A. I do.

(Testimony of Robert R. Webb.)

Q. And what is the amount shown for the cafe on that sheet, sir? A. $392.75.

Q. Where did you get the information for that entry? A. From the cash sheet.

Q. That is the Exhibit that you have just been testifying to as Exhibit M, under S-59; is that correct, sir? A. Yes, sir.

Q. Now, would you examine Exhibit Q for identification, and see whether or not the handwriting in that book is yours? A. Yes, it is.

Q. Look on the other sheets, if you please, Mr. Webb. A. On the whole, on this——

Q. Yes, just run through it.

A. Yes. It is all mine, with the exception of a few days. [69]

Q. And those days, whose handwriting is there, if you can state?

A. Well, I imagine Miss Goldstein. I couldn't—

Q. You don't know? A. No.

Q. Who took care of that book when you were absent, sir? A. Miss Goldstein.

Q. Did you instruct her as to how to take care of the book? A. Yes, sir.

Q. Now, would you state just once again what were the correct receipts for the date February 17, Sunday, from the French Cafe?

A. $546.14.

Q. And what were the receipts that you recorded to give to the bookkeeper, to show the receipts for that day? A. $392.71.

Q. Well——

(Testimony of Robert R. Webb.)

The Court: Were there similar reductions throughout the year for each day?

The Witness: Yes, sir.

Mr. Gardner: At this time, I would like to offer in evidence Respondent's Exhibit Q. [70]

The Court: Admitted.

(The document heretofore marked Respondent's Exhibit Q for identification, was received in evidence.)

Q. (By Mr. Gardner): Now, do you know, of your own knowledge, when the French Cafe first became a partnership, sir?

A. The French Cafe, with Mr. Bender, you mean?

Q. Yes.

A. I believe it was in May, 1946.

Q. May of 1946.

After Mr. Bender became a partner, with Mr. Rau, did you continue to keep such records as we have here examined for the years 1942, '3, '4, '5, and '46? A. No, sir.

Q. You did not. Did you continue to keep the receipts, though, for the Southern Wine and Liquor Store? A. Yes, sir.

Q. You did that on up until the time that that—— A. Yes, sir.

Q. ——enterprise ceased to exist; didn't you?

A. Yes, sir.

Q. Now, relating to these understatements that you have testified to, and referring to the French

(Testimony of Robert R. Webb.)

Cafe, I believe you testified that $10 a day was deducted from [71] the receipts?

A. Yes, sir.

Q. And placed in an envelope?

A. Yes, sir.

Q. Subsequently given to Mr. Rau.

A. No. It wasn't given to Mr. Rau. It was put in an envelope and was put in the safe.

Q. Put in the safe?

A. At the end of the month, he would get the envelope.

Q. At the end of the month, he would get the——

A. It was 30 days in the month, he would get $300.

Q. Would that apply throughout the year 1942?

A. Yes, sir.

Q. Did it apply throughout the year 1943?

A. Yes, sir.

Q. Did it apply throughout the year 1944?

A. Yes, sir.

Q. Did it apply throughout the year 1945?

A. Yes, sir.

Q. Did it apply up to the time that the French Cafe became a partnership on May 6, 1946?

A. Yes, sir.

Q. Now, also during that period of time, I believe you testified that on Saturdays, $100 would be taken off the [72] top and on Sundays, $100 or more?

A. Usually $100 or maybe more; yes, sir.

Q. Would be taken off and that also would be

(Testimony of Robert R. Webb.)

placed in an envelope and given to Mr. Rau; is that correct, sir? A. Yes, sir.

Q. Now, did that continue throughout the year 1942? A. Yes, sir.

Q. The year 1943? A. Yes, sir.

Q. The year 1944? A. Yes, sir.

Q. The year 1945? A. Yes, sir.

Q. The year 1946, up to the time that the French Cafe became a partnership on May 6, 1946?

A. At that time, after that, there was nothing taken out; yes, sir.

Q. But up until that time, were these amounts taken out? A. Yes, sir.

Q. Would you like to look at this, Mr. Simpson, I am going to offer this again.

At this time, I offer in evidence Respondent's Exhibit M. [73]

Mr. Simpson: Same objection, your Honor, on the grounds that this witness is not competent to testify with respect to most of the items contained in that exhibit.

The Court: Mr. Gardner, you have gotten a certain amount of testimony from the witness about certain of the sheets in this proposed exhibit. As to those particular sheets, I am certainly, I am prepared to admit the exhibit.

Mr. Gardner: Very well, your Honor.

The Court: You wish me to admit it beyond those sheets? I suggest that you obtain at least some general testimony from the witness that those other

(Testimony of Robert R. Webb.)

sheets followed the same pattern and handled in the same manner.

Mr. Gardner: Very well.

The Court: You can do as you please. If you wish to offer it merely for the sheets that you interrogated the witness on, I will receive it for those sheets. If you wish to offer it for broader purposes, you need more foundation.

Mr. Gardner: Very well, your Honor. I shall get more foundation, because I would like to get the document in.

Mr. Simpson: What is that exhibit number again?

Mr. Gardner: M.

Q. (By Mr. Gardner): [74] Mr. Webb, referring to Respondent's Exhibit M, under sheet S-8, would you state whether or not your handwriting appears thereon? A. It does.

Q. And is this sheet, would you state what that sheet is?

A. That is the cash sheet from the French Cafe.

Q. For what date, sir?

A. September 25, 1943.

Q. Now, would you examine each of the sheets, S-10—I believe you testified as to sheet S-9.

A. That is mine.

Q. Would you examine these, the sheets in the Exhibit M, and state generally whether or not those sheets are the cash sheets from the French Cafe?

A. To the best of my knowledge, they are all French Cafe.

(Testimony of Robert R. Webb.)

Q. And do these sheets indicate thereon the general practice that you have described, that is of taking off $10 during the week days, and the $100 or more on Saturdays and Sundays, and holidays, as to the French Cafe? A. Yes, sir.

Mr. Gardner: At this time, I again offer Respondent's Exhibit M.

The Court: Admitted. [75]

(The document heretofore marked Respondent's Exhibit M for identification, was received in evidence.)

Mr. Gardner: If the Court please, it is my understanding that daily sheets such as these in Respondent's Exhibit M, as to the year 1942, do not exist. We have been unable to locate any of them.

However, I would like to offer in evidence the year book as soon as it has been properly identified, relating to that year, 1942.

The Court: You mean sheets were not kept, or that they are not available?

Mr. Gardner: I believe the testimony will show that there were sheets that were kept, similar to those, but they are not now available.

Would you mark that for identification, please?

The Clerk: Respondent's Exhibit R.

(The document above referred to was marked Respondent's Exhibit R for identification.)

Mr. Gardner: Now, the same situation applies

(Testimony of Robert R. Webb.)

as to the daily sales slips testified to regarding the Southern Wine and Liquor Store.

Mr. Simpson: If your Honor please, if Counsel wants to testify, then he ought to do it in the right way. He can't say the same situation exists. [76]

The Court: Sustained.

Mr. Gardner: Do you have those records—excuse me.

The Court: I sustained Counsel's objection.

Mr. Gardner: Yes. Might I ask Counsel for the Petitioner whether he has the records of the Southern Wine and Liquor Store, including the daily slips?

Mr. Simpson: Do I understand this to be a demand for those records now, Mr. Gardner?

Mr. Gardner: Yes, it is.

Mr. Simpson: You have all the records that are in existence.

Mr. Gardner: Did you present those records, Mr. Simpson?

Mr. Simpson: What records?

Mr. Gardner: The daily sales slips of the Southern Wine and Liquor Store?

Mr. Simpson: There are none in existence.

Mr. Gardner: Thank you, sir.

Mr. Simpson: Now, that you are asking me back and forth in the courtroom, to my knowledge, they never were in existence.

Q. (By Mr. Gardner): Mr. Webb, I hand you what has been marked for identification as Respond-

(Testimony of Robert R. Webb.)

ent's Exhibit R. Would you examine [77] that document and tell the Court what it is?

A. This book is the actual deposits made for 1942.

Q. Is it writing?

A. For French Cafe and the Southern Bar.

Q. Is the writing in that, your writing, sir?

A. Yes, sir.

The Court: By the words "actual deposits," do you mean the same thing here that you meant in connection with the other years; namely, that the actual deposits were in amounts that were less than the amounts of the actual receipts?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Does that apply throughout this year, Mr. Webb?

A. Yes, sir.

Q. As to both the French Cafe and the Southern Wine and Liquor; is that correct, sir?

A. Yes, sir. Here is things here, of course——

Mr. Simpson: I would like to have something clarified, your Honor. Mr. Webb is testifying that applied to the French Cafe, with evidence given to him for that purpose.

There is no corresponding evidence with respect to any records maintained in that manner, with respect to Southern Wine and Liquor. So, I object to any testimony [78] through this witness that there were books and records kept like this for Southern Wine and Liquor.

Mr. Gardner: What is this—excuse me, your

(Testimony of Robert R. Webb.)

Honor. I believe, if the Court examines the documents, that is these books, they will find that on one column there is a column marked bar, that column refers to the Southern Wine and Liquor, and French Cafe.

The Court: Does the column marked bar refer to Southern Wine and Liquor, Mr. Webb?

The Witness: Yes, sir.

Mr. Simpson: That may be true, but with respect to the daily sheets in which he is allegedly talking about, withdrawals, there is no such existence of any sheets that were ever maintained in that fashion. The Petitioner has never had any knowledge of that, at any time.

I object to this witness testifying that there, they were in existence. If he has it, then I think it would be proper that it be introduced through him. Let him testify about it.

The Court: I seem to recall that there was evidence from this witness as to the withholding of $25 from the receipts of the Southern Wine and Liquor enterprise. Whether or not the withholding is reflected, a particular sheet similar to the sheets on which this French Cafe receipts were shown, is not a matter that would render the witness' [79] testimony incompetent.

If he knows that there was $25 a day withheld from the receipts of the bar, and that the entries on Exhibit R, for identification, show those reduced amounts, he may so testify.

Mr. Simpson: Well, I didn't understand that

(Testimony of Robert R. Webb.)

Exhibit R showed a reduced amount. That is the basis for my objection.

The Court: Counsel may develop that with the witness.

Mr. Gardner: Very well, your Honor.

The Court: I would, understood his testimony to be to that effect, but I think now that you have raised the question, I think it would be well to have it cleared up once and for all.

Mr. Simpson: Yes.

Mr. Gardner: Very well, your Honor.

Q. (By Mr. Gardner): Could I have the year 1942, please. May I——

A. This is '42 here.

Q. All right, fine. Referring to Exhibit R, Mr. Webb, would you identify, if you can, the purpose of this document, and what it contains?

A. Contains the amount that was deposited in the bank, the actual deposit. [80]

Q. For what enterprise?

A. For the French Cafe, and the Southern Bar, Southern Wine and Liquor Company.

Q. Does it reflect the deposit for that date, sir?

A. Yes, sir.

Q. And the deposit, as you refer to that, is that also the total receipts that you gave the bookkeeper to record as receipts for that day, from each of these enterprises? A. Yes, sir, it is.

Q. Now, I believe you testified that, as to the Southern Wine and Liquor Store, the receipts were understated in the amount of $25 a day, and on

(Testimony of Robert R. Webb.)

Saturdays and Sundays and holidays, the receipts were understated in the amount of, from $100 to $200 each day; is that correct, sir?

A. Yes, sir.

Q. Now, the amounts shown in this book—this is Exhibit R—those amounts, do they reflect the amounts that you took off the top, that is the $25 and the $100, or are those amounts omitted from the amounts reflected in that book?

A. That is omitted.

Q. In other words, the receipts, or the deposits shown in that book are understated?

A. Yes, sir. [81]

Q. As to the Southern Wine and Liquor Company; is that correct, sir?

A. Yes, sir.

The Court: Then they do not show the total receipts from the Southern Wine and Liquor Company?

A. No, sir. In 1942, I can't swear that there is any $100 taken off, $25, but I couldn't swear there was any $100 that year.

Q. (By Mr. Gardner): You couldn't swear there was $100 taken off?

A. Otherwise, the amounts I can't remember back that far.

The Court: Well now, your statement is confusing and you have been mumbling and I haven't gotten everything you said. I would like to get quite clearly just what your testimony is.

Is it your testimony that $25 a day was taken out in 1942?

(Testimony of Robert R. Webb.)

The Witness: $25 a day; yes, sir.

The Court: But you say you cannot testify that anything more than that was taken off in 1942?

The Witness: For that first part of 1942.

The Court: The first part of 1942?

The Witness: Yes, sir.

The Court: When, according to your best recollection, [82] did the practice commence of taking off more than $25 a day on week ends?

The Witness: After the war started, after the war.

The Court: After the war started?

The Witness: Well, maybe a few months after the war started.

The Court: A few months after, and by the starting of the war, you refer to the Pearl Harbor Day?

The Witness: Yes, sir.

The Court: Then, can you give me your best recollection as to the time when the practice began to take off more than $25 a day on particular days, such as week ends and holidays?

The Witness: Well, sometime in 1942.

The Court: Sometime in 1942.

When, according to your best recollection?

The Witness: To the best of my recollection, it would be probably latter part of 1942. I couldn't—I am not sure before that.

The Court: That isn't quite consistent with your remarks of a bit earlier, that it was just a few months after the war started.

(Testimony of Robert R. Webb.)

The Witness: I think we were talking more about the French Cafe, about the taking off. I don't think there was anything said about the Southern Wine and Liquor [83] Company, was there outside of $25.

The Court: Let's take these things one at a time now. Let's get back to the French Cafe.

The French Cafe, as I understood your testimony, involved the taking off of $10 a day on a daily basis.

The Witness: Yes, sir.

The Court: Plus larger amounts on days when the cafe did a considerable amount of business?

The Witness: Yes, sir.

The Court: Those would be week ends and holidays?

The Witness: Yes, sir.

The Court: Now, when did that practice commence?

The Witness: That started right after the, around Pearl Harbor time.

The Court: In other words, that practice would continue throughout the year 1942?

The Witness: Yes, sir.

The Court: All right. Now, let's come to the bar. Did the practice of taking off $25 a day exist throughout the year 1942?

The Witness: That started in 1942, but I don't know what date.

The Court: The record is in some confusion up to this point on this matter, and I will try to leave it to Counsel to clear it up. [84]

Mr. Gardner: All right, your Honor.

(Testimony of Robert R. Webb.)

Q. (By Mr. Gardner): Referring to the bar, that is the Southern Wine and Liquor Store, now, would you tell us when the practice, approximately when the practice started of taking off $25, not $100, but the $25 a day?

A. Approximately first part of 1942.

Q. That started in the first part of 1942?

A. Yes, sir, approximately that time.

Q. Now then, as to the taking off of $100, or on up to $200 on Saturdays and Sundays and holidays, when did that practice start, as to the Southern Wine and Liquor?

A. This, to my knowledge, would be latter part of 1942.

Q. The latter part of 1942. Is there anything that fixed that in your mind, Mr. Webb?

A. Well, my receipts.

Q. Your receipts, sir? All right. Would you state just how that——

A. This is the first time I have seen this book since 1947; so, since 1942——

Q. You are referring to Exhibit what, sir, Exhibit R? That is the receipt book for the year 1942, is it, Mr. Webb?

A. This is the receipts for 1942. [85]

Q. Those are the receipts for 1942? All right. Now, what in there refreshed your recollection?

A. Well, the amounts.

Q. In what way did the amounts?

A. Well, the amounts, the bar jumped up.

Q. The bar jumped up?

(Testimony of Robert R. Webb.)

A. The receipts went up.

The Court: Went up in the early part or latter part?

The Witness: The latter part of 1942.

The Court: That doesn't make sense to me, because if they were being taken off, if the practice commenced in the latter part of 1942, to take off these amounts of $100, I would think that the receipts would diminish, rather than increase.

The Witness: Well, when business got better, we took in more money. We had——

Mr. Simpson: If your Honor please, just observed Counsel going back and talking to another witness in this case, an employee. I would like the record to show that he went back and consulted with the question that was pending on this to this witness.

Mr. Gardner: Yes, the witness I consulted in the back of the room is Miss Rose Goldstein.

The Court: Proceed. [86]

Q. (By Mr. Gardner): Now, this is the first time you have seen this book in sometime, is it not, Mr. Webb? A. Yes, it is.

Mr. Simpson: Objection, leading question, your Honor.

The Court: I think that Counsel merely restated what the witness had previously said.

Mr. Simpson: I withhold the objection.

The Court: In any event——

Q. (By Mr. Gardner): Are you——

(Testimony of Robert R. Webb.)

The Court: I am satisfied as to the admissibility of the Exhibit R.

Mr. Gardner: Yes, all right.

The Court: Whatever doubts have been raised during the recent examination of the witness in my judgment go merely to the reliability of the exhibit, and not to its admissability.

Mr. Simpson: That is correct.

Mr. Gardner: Before we leave that portion of it, your Honor, I would like to offer this in evidence, Exhibit R.

The Court: It will be admitted. [87]

(The document heretofore marked Respondent's Exhibit R for identification, was received in evidence.)

Mr. Gardner: I would like to have the record made clear as to these other exhibits. Do we have the year 1944, your Honor? Oh, here it is, back here.

Thank you, Miss Goldstein.

Q. (By Mr. Gardner): Mr. Webb, I would like you to examine each of these exhibits O, N, P, and Q, and state whether or not those books contain the receipts that you presented to the bookkeeper for each of the enterprises, French Cafe, and Southern Wine and Liquor?

A. They are.

Q. Does that apply to each one of those documents, sir? A. Yes, sir.

Q. Each one of those exhibits. And referring

(Testimony of Robert R. Webb.)

specifically to the figures shown for the Southern Wine and Liquor Store, would you state whether or not the figures shown there are the correct receipts for each day?

A. They are not the correct receipts; no, sir.

Q. Now, does that apply to each one of those exhibits that I just stated now, that refers to the—These exhibits are books for each of the years, 1943, 1944, [88] 1945 and 1946? A. Yes, sir.

Q. I would like to have this marked as Respondent's next in order.

The Clerk: Respondent's Exhibit S.

(The document above referred to was marked Respondent's Exhibit S for identification.)

Q. (By Mr. Gardner): I show you what has been marked for identification as Respondent's Exhibit S, the year book 1947, and ask whether or not you can identify the writing in that book?

A. That is my writing.

Q. That is your writing? A. Yes, sir.

Q. And what are those figures in there, and to what enterprise or enterprises, if any, do they apply?

A. That is the record of the French Cafe, and Southern Bar, for the bookkeeper and the amount of deposit that was deposited in the bank.

Q. Referring only to the Southern Wine and Liquor now, are the amounts shown in there the correct amounts received each day?

Mr. Simpson: Objection, that calls for a conclu-

(Testimony of Robert R. Webb.)

sion from the witness, whether or not the receipts are correct. I think what he has to do, is to show the [89] top figure, whoever that person was that made the entry, and then follow it through.

He is calling for a conclusion as to whether or not the receipts are correct.

Mr. Gardner: I think he can state whether or not those figures are correct, your Honor, if he knows of his own knowledge whether or not they are correct.

The Court: If this witness continues the practice in the year 1947 of checking the cash register and going over the tapes, if he is familiar with the practice that he followed in making the entries in Exhibit S, he is competent to testify whether the entries in Exhibit S are correct.

I suggest that Counsel for the Government lay the foundation for showing that he did follow the same practice in '47 that he followed in earlier years, if true.

Mr. Simpson: Yes, but the problem here, I think, is a little bit different, because in '47, with respect to these sheets, I haven't seen anything put into evidence in this trial that indicates that these daily books that they are talking about are tied in with any daily receipts, or sheets rather, that do coincide with the practice that this witness has testified to, with respect to the prior years, or those prior to 1947.

Looks like that there is a hiatus in this [90] testimony, as to this year book for '47. Now, if the

(Testimony of Robert R. Webb.)

Counsel can tie it in, then you may have something else, but——

The Court: Whether there were sheets or not, if this witness has a basis for knowing what the actual receipts were, and if it was his practice to make the entry in Exhibit S, in such fashion as to scale those receipts down, and certainly he is in a position so to state.

I think it requires some more foundation from the witness, and, than has thus far been brought before the Court.

Mr. Gardner: I apologize, your Honor. It was my impression that I had asked him these various questions through each of the years as to the Southern Wine and Liquor.

The Court: You may have, and if you have, it has escaped me, but I think the purpose of tying things together at this point——

Mr. Gardner: Very well, your Honor.

The Court: To make it clear beyond a doubt.

Mr. Gardner: Very well, your Honor.

Q. (By Mr. Gardner): Now, you have testified previously that you were instructed to withhold $25 from the receipts of the Southern Bar, Southern Wine and Liquor Store? [91] A. Yes, sir.

Q. And further, that you were instructed to withhold amounts varying from $100 to $200 on Saturdays, Sundays and holidays, from this enterprise?

A. Depending upon the amount of business we did; yes, sir.

Q. And who so instructed you as to that, sir?

(Testimony of Robert R. Webb.)

A. Mr. Walter Rau.

Q. Walter F. Rau. Did that practice continue through the year 1942?

A. The $25 a day and the $10 a day.

Q. Let's confine our activity or testimony to the Southern Wine and Liquor only.

A. $25 a day.

Q. $25 a day you said? A. Yes, sir.

Q. And the amounts of $100 to $200 started sometime in 1942?

A. Sometime, I figure, to my knowledge, late in 1942.

Q. Late in 1942. Now, did that practice continue through 1943? A. It did.

Q. That is as to the $25 every day?

A. Yes, sir. [92]

Q. And as to the $100 to $200 on Saturdays, Sundays and holidays, relating now to the Southern Wine and Liquor Store; is that correct, sir?

A. Yes, sir.

Q. These amounts were reduced from the amounts that you recorded in these exhibits we have just been examining; that is, these year books for 1943, 1944, 1945, and 1946; is that correct, sir?

A. Yes, sir.

Q. And did that practice continue up to August 7 of 1947, when the Southern Wine and Liquor Store ceased doing business?

A. It continued up to July. I don't know whether we went up to the last day or not. I couldn't swear to that.

(Testimony of Robert R. Webb.)

Q. Would you say whether it continued——

A. Through July.

Q. Through July, all right, sir.

The Court: Through July or to July?

The Witness: Through July.

The Court: Through July.

Q. (By Mr. Gardner): Continued through July? A. Yes, sir.

Q. Now, referring once again to Exhibit S, would you [93] examine the entries in there, and tell us just exactly what that book is?

A. This is a record for the French Cafe, and the Southern Bar, the actual deposits that were made, and it was used by the bookkeeper for—given to the bookkeeper for her records.

Q. Now, you have stated that $25 a day was omitted from the records that you gave to the bookkeeper.

Are those figures that you have there showing the deposits, or the receipts for each day for the Southern Wine and Liquor?

A. The $25 had been taken off before these figures were arrived at.

Q. In other words, those figures are $25 short?

A. Yes, sir.

Q. For every day? A. Yes.

Q. And what about Saturdays, Sundays and holidays, are they short? A. Short.

Q. How much?

A. Well, it could be $100 or $150 or, depending upon the amount of business we did.

(Testimony of Robert R. Webb.)

Q. Depending upon what Mr. Rau told you to —wouldn't it? [94] A. Yes, sir.

Q. Now, I notice here that you are also keeping the French Cafe, some sort of record pertaining to the French Cafe, are you not, sir?

A. Yes, sir.

Q. Were you handling the deposits for that partnership; was that a partnership at that time, sir? A. No, sir.

Q. That is in 1947, if you will examine that.

A. The partnership with Mr. Bender, I think, was May, 1946.

Q. Yes.

A. There was nothing taken out after that, to my knowledge.

Q. Nothing was taken out after that?

A. No, sir.

Q. But you still continued to make the deposits for that? A. Yes, sir.

Q. And that is why that is shown in this book; is that correct, sir?

A. 1946. Yes, that is the actual deposits.

Q. Those are the actual deposits; those are the actual receipts?

A. Of the French Cafe, actual receipts. [95]

Mr. Gardner: At this time, I once again offer in evidence Respondent's Exhibit S.

The Court: Admitted.

(The document heretofore marked Respondent's Exhibit S for identification, was received in evidence.)

(Testimony of Robert R. Webb.)

The Court: We will recess until tomorrow morning at 10:00 o'clock.

(Whereupon, at 4:10 p.m., the hearing was recessed until 10:00 o'clock a.m., Friday, June 27, 1958.) [96]

The Clerk: Docket No. 61480, Estate of Walter Rau, Sr.

Mr. Gardner: Earl Gardner for the Respondent.

Mr. Schessler: John Schessler for the Respondent.

Mr. Simpson: E. T. Simpson for Petitioner.

Mr. Gardner: I believe Mr. Webb was on the stand.

ROBERT R. WEBB

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Direct Examination

(Continued)

By Mr. Gardner:

Q. Mr. Webb, I believe you testified yesterday that you were first employed by Mr. Rau in the year 1932; is that correct, sir? A. Yes, sir.

Q. That you continued in his employment, that is as a clerk in the hotel, and as manager of the hotel, and the French Cafe, the Southern Wine and Liquor Store, on up to the time that the French Cafe became a partnership in May 6 of '46, and as far as the hotel and the Southern Wine and Liquor

(Testimony of Robert R. Webb.)

Store is concerned, up until the time the building was demolished in August 7 of 1947; is that correct? A. Yes, sir.

Q. Now, during that period, Mr. Webb, did you have [99] an opportunity to observe Mr. Rau's physical condition? A. Yes, I did.

Q. Did you work closely with Mr. Rau?

A. Yes, sir.

Q. What was his physical condition during the years 1942 to 1947, sir?

A. Well, his physical condition was good up until maybe the last two years, outside of his—mentally he was very sharp.

Q. Did he keep——

Mr. Simpson: Objection, your Honor. I believe that this witness isn't qualified to testify as to the mental sharpness of this Mr. Rau.

Mr. Gardner: If the Court please, from his observations and close working with Mr. Rau, I believe this witness is qualified to give his impression of the physical infirmities, and apparent to him, any mental disabilities that he may have observed.

The Court: I will receive this testimony as a layman's observation. A layman can certainly tell whether a person is responsive or unresponsive. I will not receive it as any technical medical evidence, but I will receive it as a layman's observation.

Mr. Simpson: All right.

The Court: As to the mental alertness of Mr. Rau. [100]

Q. (By Mr. Gardner): Would you state once

(Testimony of Robert R. Webb.)

again, sir, from your own observation, your opinion as to the mental alertness of Walter F. Rau, Sr., during the period 1942 to August 7, 1947?

A. Well, I saw Mr. Rau nearly every day, with the exception of when he may have gone down to Hot Springs for two days, or maybe as long as a week, on rare occasions.

He watched every penny, as far as I could see. There was occasions when, oh, maybe he would have a bill from the hotel for maybe for soap or linens, where we would receive maybe three per cent, or one per cent, if paid within 30 days, and if it went over 30 days, I would make the check out for the full amount. But he looked at the check and make me make out another check for the, take off the three per cent.

That way I figured his mind was very keen.

Q. Did he keep a close track of the moneys that you withheld for him?

A. Every day when he was at the hotel, he would be downstairs, practically every day the check books, the deposit books were all kept right in the front desk, in an open desk, for him to examine.

Q. Did he examine them; did you observe him examining them? [101]

A. Oh, yes, plenty of times.

Q. Now, you stated that up until the last two years he was fairly well, physically; what happened during the last two years, that would be 1946 and 1947?

A. Well, I think probably part of 1946, he

(Testimony of Robert R. Webb.)

moved out of the hotel to a home he had bought in town, and he would drive in most every day, or maybe I would walk to his home to look up the receipts.

Q. What was wrong with him, if you know?

A. Well, he had a lot of trouble with his legs. If he went to the bank, Anglo Bank, to his cash box, I would probably walk down with him to sort of help him along. He used a cane. He was a big man and he had a little hard time, you know, navigating the street.

Q. Now, was he also ill during 1942, '3, '4, and '5?

A. He had pneumonia, I think, was in the hospital for maybe three or four days, at the Mercy Hospital.

Q. What time was this?

A. Well, somewhere between '42 and '45, I would say.

Mr. Gardner: No further questions, your Honor.

Cross-Examination

By Mr. Simpson:

Q. Mr. Webb—— A. Yes, sir. [102]

Q. Just to review very briefly, you began your employment as a clerk? A. Yes, sir.

Q. In 1932? A. Yes, sir.

Q. At what time did you become the manager?

A. Well, I worked as a clerk even when I was named manager, up until, maybe, 1945 or '46.

Q. You worked as a clerk?

(Testimony of Robert R. Webb.)

A. I also had the title as manager.

Q. You worked as a clerk and as the manager?

A. I worked at the desk as a room clerk; yes, sir.

Q. And——

A. From seven in the morning until seven in the evening, with two hours off in the afternoon.

Q. Let's try to be very definite about this.

A. Yes, sir.

Q. As a clerk, what were your duties?

A. As clerk, my duties were to deposit all the receipts from the Southern Hotel, the French Cafe, and the Southern Bar.

Q. Is the Southern Bar the same thing as the Southern Wine and Liquor? A. Yes, sir.

Q. As manager, what were your duties? [103]

A. As manager, I didn't do any of the hiring. I had nothing to do with the French Cafe, outside of the banking the receipts in the morning.

Q. Say that again.

A. I had nothing to do with the French Cafe, with the exception of banking the receipts in the morning.

Q. Now, you said what you didn't do as a manager; tell me what you did do, as a manager?

A. I didn't do any buying.

Q. Well, don't tell me what you didn't do, please, tell me what you did do, Mr. Webb.

A. Well, I handled the bellboys.

Q. You handled the bellboys?

A. Hire a clerk, maybe night clerk, maybe, or about all, and the maids.

Q. Well, just a minute, Mr. Webb. Before you

(Testimony of Robert R. Webb.)

continue, did you just state earlier that you didn't do any hiring, had nothing to do with personnel?

A. Nothing to do with it in the French Cafe.

Q. Now, it is nothing to do with it in the French Cafe? A. Yes, sir.

Q. Is that the answer? A. Yes, sir.

Q. Now, with respect to what enterprise did this hiring have to do? [104]

A. Well, I hired the bellboys, some of the maids, and the night clerk.

Q. Now, as manager of what?

A. That is of the hotel, not the French Cafe, or the Southern Wine and Liquor Company.

Q. You had nothing to do with the Edmund Hotel?

A. Not—I had nothing to do with the Southern Bar.

Q. Just answer the question yes or no, did you have anything to do with the Edmund Hotel?

A. I don't understand.

Q. As manager, did your duties encompass anything with respect to the Edmund Hotel?

A. Nothing.

Q. Nothing? A. No, sir.

Q. I want to find out exactly what you did not have, any trouble—you were the manager of the Southern Hotel? A. Yes, sir.

Q. Now, your management of that hotel included such things as hiring bellboys or maids?

A. Yes, sir.

Q. What else did it include?

(Testimony of Robert R. Webb.)

A. Well, I worked directly under Mr. [105] Rau.

Q. You worked directly under Mr. Rau; where was Mr. Rau?

A. He was at the hotel practically every day.

Q. Did Mr. Rau——

A. He lived at the hotel.

Q. Mr. Rau didn't need you as a manager then, did he?

A. The title of manager didn't really mean very much.

Q. Well, you used it now. I want you to tell me what you did as manager?

A. I thought I told you. I hired the bellboys and the maids.

Q. And that is all you did as manager; let's get it straight now.

A. Well, the buying was all done by Mr. Rau. Outside of maybe a little incidental I might buy.

Q. Outside of incidentals, tell us what the incidentals are now?

A. Oh, might be little odds and ends we needed in the office for pens; and no stationery, no linens, nothing like that. Mr. Rau did the buying of all that.

Q. Did you do any buying for any other business?

A. I did the buying in the bar, about, maybe two years or year and a half, or two years. I am not sure. I don't remember exactly. [106]

Q. Let's get the years that you did the buying for the bar.

A. Well, I would say, to my best recollection, it

(Testimony of Robert R. Webb.)

would be 19—latter part of 1945 and '46, up until the close of the bar.

Q. The bar. Did you do buying for any other business that Mr. Rau had? A. No, sir.

Q. Just on the bar? A. Yes, sir.

Q. That is the Southern Wine and Liquor Company? A. Yes, sir.

Q. Is that correct, sir? A. Yes, sir.

Q. How did you do the buying, by cash?

A. No, sir, by check.

Q. By check? A. Yes, sir.

Q. Did you get the checks? A. Yes, sir.

Q. Now, suppose you explain the manner in which you paid payments by check?

A. Well, it was shipment of beer came in, I would make a check out and pay right then. [107]

Q. When the beer came in where?

A. At the Southern Wine and Liquor, at the bar.

Q. Well now, where you working as manager while at the hotel, while you were paying the bills at the bar?

A. Well, the hotel wasn't a very large hotel. I was all over the place.

Q. You were all over the place, French Cafe, the bar and the Southern Hotel?

A. I was rarely in the French Cafe.

Q. Rarely in the French Cafe.

A. Outside of going through it to go, get to the bar; yes, sir. I didn't take any cash off, the cash was all handed to me in the morning. I didn't do any buying in the French Cafe.

(Testimony of Robert R. Webb.)

Q. And the cash was handed to you from where, in the morning?

A. From the French Cafe, the receipts.

Q. Where were they handed to you; where were you?

A. I was in the Southern Hotel, back of the desk.

Q. You were in the hotel? A. Yes, sir.

Q. What time of the morning were they brought to you? A. Sometime after seven a.m.

Q. What time did you begin your work? [108]

A. Seven a.m.

Q. Seven a.m. and when did you stop work, close at what time?

A. Seven p.m., up until about 1945.

Q. Now, in working from seven—wait a minute now—seven a.m. to seven p.m., up to when, Mr. Webb, again?

A. I am not positive, but it was sometime, probably, in 1945.

Q. After that, what were your hours?

A. After that, we hired a clerk to work in the daytime. I relieved him. I worked from about ten o'clock in the morning till about five, or maybe six.

Q. After you hired the clerk, what did he do?

A. He worked at the front desk as room clerk.

Q. Front desk. When did he come on?

A. Seven o'clock in the morning.

Q. When did he leave?

A. I believe it was seven in the evening, but he probably took couple hours off in the afternoon to take a rest.

(Testimony of Robert R. Webb.)

Q. Well, from 1945 up in the end of 1947, you worked from ten o'clock in the morning till five o'clock; the clerk was working from seven o'clock till seven; is that right? [109]

A. That is right.

Q. While he was working, what did you do, Mr. Webb?

A. Well, I would check the rooms, the hotel rooms, to see that the maids were working.

I would check the bar and maybe relieve the clerk at times, and keep order in the hotel.

Q. I want to get this straight again, when the clerk came in to work in 1945, did he come in to relieve you of certain duties that you had before that time?

A. Yes. I was taken sick about that time, and Mr. Rau said, thought, well I better have some help there.

Q. Where were you confined during your illness?

A. I was confined to the Mercy Hospital.

Q. Mercy Hospital?

A. Mercy Hospital, yes, sir.

Q. For how long?

A. Not more than two or three days. Then I was confined to my home for maybe another week or ten days.

Q. Week or ten days. So, it is about 13 days?

A. Well, I couldn't swear to the days.

Q. Well, that is close enough. We won't quibble about whether it is 12 or 13.

A. Maybe ten days.

(Testimony of Robert R. Webb.)

Q. What month?

A. I don't remember. [110]

Q. What year?

A. I am not sure of that. I think it was 1945.

Q. Well, the clerk was there, wasn't he?

A. At times, Miss Goldstein relieved at the desk. I think at the time I was taken to the hospital, she probably relieved at the desk.

Q. Probably, you don't know whether she was working at the desk or not?

A. She had an office right in the lobby of the hotel, a desk.

Q. Had an office?

A. Had a desk right in the lobby.

Q. I thought she was a bookkeeper for Mr. Rau?

A. She was, but she also relieved at the desk once in a while.

Q. You say she had an office?

A. She had a desk in the lobby of the hotel.

Q. Had a desk. Now, where is the office, Mr. Webb, what kind of an office did Miss Goldstein have?

A. Well, there was no closed off office, it was just, had a desk right in the center of the lobby.

Q. Did she conduct some kind of business from that hotel?

A. She did the bookkeeping for Mr. Rau. She also——

Q. Answer the question, please. Did she conduct a [111] business from that hotel?

A. Did she conduct a business from that hotel?

(Testimony of Robert R. Webb.)

Q. Yes. A. Yes.

Q. What kind of business?

A. Income tax business.

Q. Income tax business?

A. Notary Public.

Q. Notary Public? What else?

A. Public stenographer.

Q. Public stenographer. Did she do such things as mimeographing? A. I believe she did.

Q. Did she have her own stationery?

A. I am not positive of that.

Q. Did she advertise? A. Yes, sir.

Q. Is she listed in the telephone directory in Bakersfield as a public stenographer?

A. I couldn't answer.

Q. Income tax, you don't know that? Was she the bookkeeper for Mr. Rau, as an employee, or did she operate her own business?

A. She worked under Mr. Rau, but he gave her the privilege of operating outside of the office. There wasn't [112] enough work, really, to do in the hotel.

Q. How many hours a day did she devote to Mr. Rau's bookkeeping work?

A. There wasn't any set time, as far as I know.

Q. Wasn't any set time. When did she come to work?

A. She might work all evening, maybe half a night, sometimes, all depended on how busy we were.

Q. Worked half the night. How do you know that, Mr. Webb?

(Testimony of Robert R. Webb.)

A. Well, I was in there plenty of times during the night, and seen her in there.

Q. What were you doing coming in there at night time, if you worked from seven to seven?

A. I might come in the bar and have a drink, or see some friends and do most anything.

Q. You came back to the hotel and went to the bar? A. At night time, I was there.

Q. Did you stay there until, as late as 12:00 o'clock at night?

A. I have been there later than 12:00 o'clock at night.

Q. Later than 12:00 o'clock at night?

A. Sure.

Q. You went back only, to just to see some friends at night time? [113]

A. It is possible. I don't remember the occasions, but I had friends up there, sure, plenty of friends.

Q. And during the period from 1942 up to 1945, at which time a clerk was hired to relieve you of these duties that you said you were everywhere, what was your salary? A. Not in 1942, sir.

Q. I said, from 1942 up to 1945, at which time you hired a clerk to relieve you, during that period of time, from '42 to '45, what was your salary?

A. I don't remember exactly. I think I got first about $100 a month, my room and board.

Q. You lived at the hotel?

A. I lived at the hotel until 1938.

Q. Until 1938?

A. I got married in March, about March 1.

(Testimony of Robert R. Webb.)

Q. Mr. Webb, I asked you to tell me from 1942 to 1945 what was your salary?

A. I don't remember exactly.

Q. You don't remember, you don't remember how much you made, sir?

A. I am not positive, no.

Q. Did you have such things as payrolls for the hotel? A. I didn't make out the payroll. [114]

Q. Didn't you hire the people, the maids, the bellboys? A. Yes, sir.

Q. Did you know how much they were being paid?

A. I think the bellboy was making about $4 a day.

Q. Well, did you have a record of it?

A. Oh, absolutely.

Q. Who kept the record?

A. Miss Goldstein.

Q. Now, Miss Goldstein kept the payroll records? A. Yes, sir.

Q. So, Miss Goldstein would know how much you received as a salary? A. She would.

Q. But you don't know?

A. As far as I know, I was receiving $100 a month. He raised me a couple times later. I don't know what.

Q. All right. Let's get right down to that; just a minute.

1942 to 1945, you had $100 a month; after 1945 what was your salary?

(Testimony of Robert R. Webb.)

A. I think it was $45 a week.

Q. $45 a week. '45 through 1947?

A. Yes, sir.

Q. Now, to go back again, so there is no mistake, [115] you stated that 1942 to 1945 you received $100 per month?

A. As far as I recall. I couldn't swear to it.

Q. Did you have room and board?

A. Yes, sir.

Q. In 1942 to 1945?

A. I had room and board all the time I was there, practically, if I wanted it.

Q. When did you buy your home?

A. I bought my home in 1951.

Q. In 1951? A. Yes, sir.

Q. When were you married, Mr. Webb?

A. 1938.

Q. After your marriage, where did you live?

A. After I was married, I—we had an apartment for a while, and for about, pretty near a year, I lived at the hotel, with my wife; yes, sir.

Q. For pretty nearly a year and what year was that?

A. I am not sure of that. It might have been 1942, '43, '41. I don't remember exactly.

Q. And then where did you live after that?

A. I lived at Mr. Rau's home for about five years, from 138 F Street. I think I paid him $40 a month, and everything was included, linens—I didn't buy anything. I didn't have to buy a stick of furniture or linens or [116] anything else.

(Testimony of Robert R. Webb.)

Q. If I understand your testimony correctly, you moved from the hotel around 1942 and then lived at 138 F Street in a home owned by Mr. Rau?

A. Yes, sir.

Q. For which you paid $40 a month rent?

A. Yes, sir.

Q. And you paid everything else, the expenses of that house, linens?

A. I didn't pay anything, no.

Q. You didn't pay anything?

A. He furnished all that.

Q. At that time. Now, that you were living in his home paying him $40 a month rent, you were receiving $100 a month salary——

A. At that time I think I was receiving more than $100 a month.

Q. Now, it is more than $100. Suppose you tell us how much more now?

A. I don't remember the years; I can't remember the years.

Q. Can't remember the years. You don't remember the amount? A. No, sir.

Q. That you received. Mr. Webb, please state how [117] old a man you are, sir.

A. I will be 63 years old in March, 1st of March.

Q. What is the extent of your education, Mr. Webb? A. Grade school.

Q. Grade school only? A. Yes, sir.

Q. You remember very distinctly, had a vivid recollection, as I understood your testimony yesterday, up there on the witness stand.

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. About many things that had to do with Mr. Rau's affairs, came out just like that, but about your own, there is vagueness, indefiniteness.

A. When you are doing something every day, it is pretty easy to remember, but for years in and years out every day.

Q. Every day? A. Yes.

Q. Weren't you working every day?

A. Every day with the exception of when I would take a vacation, or take a few days off.

Q. Weren't you paid every week?

A. Yes, sir.

Q. Week after week?

A. Yes, sir. [118]

Q. Year after year? A. Yes, sir.

Q. Well, can't you remember what you received?

A I can't remember the years.

Q. You can't remember the years.

I believe you testified that you remembered distinctly, even when you took money or got money from the cashier at what time of day and how much and from what business?

A. Yes, sir. Had to be after seven o'clock in the morning, between seven and ten in the morning, because the bank opened at ten o'clock. I was at the bank at ten o'clock.

Q. When you got the cash receipts from the bar, what time of day did you get those receipts?

A. I was usually come in, in four o'clock in the afternoon.

Mr. Gardner: If the Court please, there has been

(Testimony of Robert R. Webb.)

testimony here that he worked after 1945 from ten o'clock until five o'clock. Prior to that time, he was there from seven until seven.

I think Counsel should state the time more definitely so the witness can answer it intelligently.

Q. (By Mr. Simpson): At what time of day from 1942 up through and including 1947, name any year you wish, did you collect [119] receipts from the bar?

A. Four o'clock in the afternoon, and at seven o'clock in the morning.

Q. In what years did you do that?

A. That was from probably 19—well, practically every day the bar opened up, until maybe 1945.

Q. Up to 1945?

A. 1945. I would get the receipts around ten o'clock when I came in in the morning, 9:30, 10:00 o'clock.

The Court: That is the morning receipts; did you continue to get the afternoon receipts at four o'clock?

The Witness: Yes, sir, at four o'clock.

Q. (By Mr. Simpson): Now, at the time you got the receipts at four o'clock, did the bartender give you a slip of paper showing you what the cash register reading was?

A. I would take the reading, myself.

Q. You took the reading, yourself?

A. Yes, sir.

Q. And where did you put that information that you obtained from the reading of the cash register?

(Testimony of Robert R. Webb.)

A. I would take the tape with the money, the detailed tape and the money, the slip, the amount which is also on the detail tape, put it in an envelope at four o'clock.

The next morning, it would be brought in to me, or [120] we opened up at different times. Sometimes we opened up seven o'clock in the morning; sometimes I think it was eleven or ten o'clock in the morning.

Q. I am not sure that I understand your testimony, Mr. Webb. Perhaps somewhat phlegmatic, I wish you would go back over it again, sir.

You went in at four o'clock in the afternoon at the bar?

A. When I was at the hotel at four o'clock, if the bartender came in at ten o'clock in the morning, he would be off at four o'clock, and I would take his cash off, and take the reading.

Q. Did you take the cash out of his cash register at four o'clock?

A. The receipts up until that time, yes, sir, and put them in the envelope and put them in the safe.

Q. What did he do for cash to operate the business, if you took his cash out of that drawer?

A. I took the money, amount of money that he had taken in, the net receipts that he had taken.

Q. And left him with no money to operate at four o'clock?

A. We had a bank of about $200. I don't remember.

Q. If you took the reading and then took the

(Testimony of Robert R. Webb.)

man's cash at four o'clock, he wouldn't have any cash in that [121] cash register; isn't that true?

Mr. Gardner: I think this is argumentative. The witness has stated that there was a bank in the register, all that he took were the receipts for the day.

The Witness: Yes, sir.

Mr. Gardner: I don't know how many times he is going to ask the question in an argumentative manner, and I object to that.

Mr. Simpson: Until I get to the truth.

The Court: Proceed.

Q. (By Mr. Simpson): You got the cash at four o'clock? A. Yes, sir.

Q. You took the same amount from the cash register that the cash register reading indicated; is that true or not?

A. If the bartender took in $50, I would take out $50 and leave the bank. We had a bank to start with, maybe $200, maybe $300, I don't remember.

Q. Maybe $500?

A. Not as much as that, no.

Q. Well, how do you know, Mr. Webb?

A. I know it wasn't as much as $500.

Q. Did you look in his cash register?

A. Yes, I did. [122]

Q. The cash——

A. That is right. I counted the cash as I took the receipts out. I counted the cash to see if the bank was, the full bank was there.

(Testimony of Robert R. Webb.)

Q. Well, did you have a tape on that cash register? A. Yes; yes, sir.

Q. And the amount of cash that you took out, did you——

A. Was the amount that the bartender had taken in that day, that shift.

Q. That is not what I am asking you.

The amount that you took in the form of cash, did that correspond with the cash register reading?

A. Yes, sir.

Q. Did it also correspond with the tape?

A. Yes, sir.

Q. It did? A. Absolutely.

Q. Now, at four o'clock, when you took the cash, what did you do with the tape at four o'clock in the afternoon?

A. I would leave the tape intact, the full tape was taken off in the morning. I would take the ticket that the cash register drew for the amount of the receipts that the bartender had taken in, and put that money, his receipts, [123] in an envelope, put it in the safe until the next day when I got the full receipts of the bar and then it would be banked.

Q. When you testified about taking out so much money from that bar every day, and you went into that drawer on two occasions, the cash register in the bar——

A. I might have gone in more than two occasions.

Q. I mean, for the purpose of counting the cash.

(Testimony of Robert R. Webb.)

A. Yes, sir. Many times I would walk in and check a bartender.

Q. Well, at what time did you take the money off the top, as you say; was it four o'clock in the afternoon?

A. No, sir. It was the next morning when we got the full receipts of the full shift, of the full day.

Q. So, you waited until the morning. Now, you got the receipts at four o'clock in the afternoon, then at 12:00 o'clock at night the bartender was there, he added up those receipts, then you weren't there at 12:00 o'clock to count that cash in that cash register, were you, Mr. Webb? A. No, sir.

Q. So, you took only what he gave you as the receipts for that day; is that correct, or not?

A. He would leave the receipts in the cash register; the next morning I would go in, count the cash, take off the tape and leave the bank, whatever it was, if it was [124] $200 or $300, and start the new bartender off at seven o'clock.

Q. I want you to answer my question.

You didn't count that cash at 12:00 o'clock at night, did you? A. No, I didn't.

Q. And what you got was a tape, the cash register reading from the bartender the following morning, when you came to work?

A. The following morning, if I went in at seven o'clock, I would go into the bar the first thing.

Q. Will you answer the question, please?

A. I don't understand the question.

Q. You did not count the cash at 12:00 o'clock at night? A. No, sir.

(Testimony of Robert R. Webb.)

Q. The bartender did that?

A. The bartender, at times we had, at times, at first, the bartender would take the cash off and Mr. Rau changed it, leave it all in there, he said, and until the morning, and we will take it out, all out at once; outside of the four o'clock reading, I worked at seven o'clock.

Q. Mr. Rau told the bartender to take it off the top, too?

A. There was nothing taken off the top there, from [125] the bar, it was taken off the next morning after we got the full receipts.

Q. And you took it off in the morning at seven o'clock? A. When I was there; yes, sir.

Q. And now, we have it at seven o'clock in the morning that you put the money in an envelope, that you have taken off the top for the bar, for two separate countings. Now, let's see if I am correct.

You made a counting of cash at four o'clock in the afternoon; the bartender made it at 12:00 o'clock at night. You got his receipts the next morning. You already had the four o'clock receipts; didn't you? A. Yes, sir.

Q. And you had the tape, didn't you?

A. I would take the full tape off in the morning for the whole shift, the two shifts.

Q. So, the only person who knew how much cash had been taken out of the drawer would be you, Mr. Webb, at four o'clock?

A. It is possible, yes.

Q. And nobody else except you knew at four o'clock whether or not the cash that you took out

(Testimony of Robert R. Webb.)

of that drawer corresponded with the reading, and the receipts placed down there for that period, up to four o'clock? [126]

A. The reading was right on the tape. I would take the amount off and also throw a ticket for the amount that was taken in in that shift. I would put that money in an envelope with the ticket, and hold it until the morning.

In the morning, I would get the balance of the receipts and give it to Mr. Rau, and show it to Mr. Rau, and give him the tape and the ticket.

Q. Now, at four o'clock you did not have a tape, though, did you?

A. I didn't take any tape off at four o'clock, no.

Q. No. But you took the cash out?

A. That is right.

Q. Now, what I want to get straight now, is that you were the only person who went into that drawer at four o'clock in the afternoon?

A. When I was there, yes.

Q. Mr. Rau didn't go in there?

A. He never took off the cash; no, sir.

Q. He never took it off?

A. To my knowledge, no.

Q. He always had you do it?

A. I would do it, or maybe Miss Goldstein.

The Court: You are using the word take it off. As I understand it, in different instances, at times you used the word take off to mean take off the $25 each day. [127]

The Witness: Well——

The Court: And you are using the word take off

(Testimony of Robert R. Webb.)

in another sense to mean that you removed the entire receipts for a certain period, say up to four o'clock in the afternoon.

I would appreciate it if you wouldn't use the words take off and use other words to be more accurate, to describe exactly what you did.

Q. (By Mr. Simpson): Now, were those instructions, Mr. Webb, very clear?

A. I thought I was answering the question.

Q. You are an adult? A. Yes, sir.

Q. When you took the cash out of that drawer at four o'clock, were you not the only one who knew how much was taken out of that drawer?

A. The bartender would probably know what he had taken in.

Q. How would he know if he didn't read the register; you read the register.

A. The cash register would show a total receipts for the, on each shift.

Q. I understand that. I am going to get to this, Mr. Webb, if it takes us all day, I promise you. I want [128] to find out if anybody else knew how much cash you took out of that drawer at four o'clock in the afternoon.

Was there anybody else that took it out?

A. No.

Q. Just you? Answer yes or no.

A. Yes.

Q. When the money was put in the envelope in the morning at seven o'clock, again there is only one person that knew how much money was in that envelope, that is you; is that correct, Mr. Webb?

(Testimony of Robert R. Webb.)

A. No, it isn't correct.

Q. Then tell me who else knew it.

A. The money was taken out of the cash register in the morning, it was brought to me, or if I went in and got it, I would leave it all for Mr. Rau.

Q. You would give it to him?

A. I would make out a deposit after I had talked with Mr. Rau, if he was in the building.

Q. I am coming back to the same question.

When you put that money in an envelope, nobody else knew how much went in there, except you at the time you put it in? A. As far as I know——

Q. Now, answer that yes or no.

A. Well, yes, sir. [129]

Q. You were the only one that knew how much went into that envelope?

A. Well, I don't—you are kind of twisting this thing around.

Q. I am not twisting. I asked who else knew how much you put in that envelope?

A. I didn't say anything about putting anything in the envelope in the morning.

Q. Well, just when did you put it in the envelope? A. In the afternoon.

Q. In the afternoon?

A. On the four o'clock shift.

Q. Well, where was the cash that you had then at seven o'clock in the morning, if it was not in an envelope; tell the Court where it was from seven o'clock in the morning, at which time you came to work, up until four o'clock in the afternoon when you put it in the envelope?

(Testimony of Robert R. Webb.)

A. In the morning, I would get the total cash.

Q. Mr. Webb, answer my question, please.

A. And I would bank it.

Q. Where was the cash from seven o'clock in the morning up until four o'clock in the afternoon, when you put it in the envelope, as you have just testified?

Mr. Gardner: If the Court please, this witness has testified—may I speak? [130]

This witness has testified many times that the money that went into the envelope was the money that came off the first shift; that is the money that went in the envelope. He has testified that it was placed in this envelope, put in the safe, the next morning the remaining shift—that is the shift from four o'clock until they closed—that money——

Mr. Simpson: Just a minute, if your Honor, please.

Mr. Gardner: May I speak?

Mr. Simpson: Yes, but I think there is something quite not proper.

The Court: Let him complete his statement.

Mr. Gardner: I think this has been testified to many times by Mr. Webb that this money that remained in the cash register from four o'clock until the place closed, was the money that he picked up the next morning, that this money was then laid there and Mr. Rau examined that together with the money in the envelope.

Now, he has testified to that not once, but many times, and the only one that doesn't seem to under-

(Testimony of Robert R. Webb.)

stand it, I submit, is Counsel for Petitioner. The record is replete with that.

Mr. Simpson: Well, on cross-examination——

Mr. Gardner: On cross-examination.

Mr. Simpson: Is that so? [131]

Mr. Gardner: Counsel went into it many times.

The Court: This is cross-examination, and Counsel for Petitioner is entitled to explore the matter with the witness.

However, I do think that Counsel for the Petitioner is twisting the shifts around, because as I understood the testimony on at least several occasions, both on direct examination and cross-examination, the two shifts that made up the full 24 hour period, or the two collections, began with a collection at four in the afternoon, which was the first collection, and that that 24 hour period was completed by a collection the next morning, and that I think Counsel for the Petitioner was confusing things when he tried to take the morning collection and assimilate that with the afternoon collection, which followed that on the same day.

Mr. Simpson: What I——

The Court: If there is any doubt about it, you are entitled to explore it further with the witness.

Mr. Simpson: This is what I am attempting to get from this witness: the fact is, he has testified that he read the reading on the register at four o'clock, that he took cash from the drawer, at four o'clock in the afternoon.

Now, Mr. Webb stopped working at seven [132]

(Testimony of Robert R. Webb.)

o'clock at night. Now, at seven o'clock in the morning, he gets more cash, not from his own reading of the register, but from that which the bartender made. Now, at seven o'clock in the morning, Mr. Webb has additional cash.

What I am trying to determine is whether or not at four o'clock in the afternoon, when Mr. Webb took that cash from that drawer, if anybody saw how much he took, so that when you add the cash that he got from the bartender at 12:00 o'clock at night, when Mr. Webb came back to work the following morning for the purpose of writing down receipts, who else knew at that time whether Mr. Webb, because—how much money—because you have to remember this is not my design to twist, but to test this person's veracity and credibility, that when he had two occasions, number one in the afternoon, when there was no reading other than what he took, but cash.

Now, we have the following morning, based on a 12:00 o'clock reading, the full tape for the day, with cash given to him by the bartender in the morning at seven o'clock. I asked him; I think on direct testimony, though, your Honor, he testified that he put that cash in the envelope in the morning.

Now, if I am mistaken the Reporter will correct me. He has now testified on cross-examination that he didn't do it in the morning, that he waited until four [133] o'clock in the afternoon of the following day to put the cash in the envelope that he had taken or received, rather, take the word take out—

(Testimony of Robert R. Webb.)

that he had received in full from the bartender at 12:00 o'clock—I mean at seven o'clock in the morning, based on a 12:00 o'clock reading.

Now, what I want to develope from this witness is where was the cash from seven o'clock in the morning until four o'clock in the afternoon, when he placed it in an envelope, and I still haven't received an answer.

The Court: I think you are misconstruing his testimony. I believe his testimony fairly interpreted was that the money that he put in the envelope at four o'clock was the money which he took out of the cash register at four o'clock. And it wasn't kicking around anywhere over a long period of time.

Let's get this straight from the witness, himself.

The Witness: That is right, your Honor.

The Court: When you went to the cash register at four o'clock in the afternoon, you took money out of the cash register and you put it in an envelope right then and there?

The Witness: Yes, sir.

The Court: And that envelope went into the safe?

The Witness: Yes, sir.

The Court: And it remained there until [134] the following morning?

The Witness: Yes, sir.

The Court: Then on the following morning you received the remainder of the receipts that came into that cash register after four o'clock for the previous afternoon?

(Testimony of Robert R. Webb.)

The Witness: Yes, sir.

The Court: And you added those receipts together with what you had taken out of the cash register at four o'clock in the afternoon of the previous day?

The Witness: That is right, sir.

The Court: And those two amounts together made the total of the receipts for a full day?

The Witness: Yes; yes, sir.

The Court: That is what I understood your testimony to be.

The Witness: That is right, sir.

The Court: And in the morning, was there a complete tape for the entire day?

The Witness: There was, sir.

The Court: So that the two amounts taken out, one at four o'clock and the amount that was brought to you in the morning, when added together, should have equalled the amount shown on the tape?

The Witness: That is right, sir. [135]

The Court: And did they equal the amount shown on the tape every day?

The Witness: Yes, sir.

The Court: And then in the morning after the two amounts were put together, that is to say the amount that was taken out of the cash register at four o'clock the preceding day, as augmented by the amount that you received the following, that same morning, that aggregate amount or sum portion of it was banked, was deposited in the bank during that very morning? A. Yes, sir.

(Testimony of Robert R. Webb.)

The Court: Now, was the entire amount put in the bank?

The Witness: No, sir.

Q. (By Mr. Simpson): The entire amount that was put in the envelope was not put in the bank?

A. Not the entire amount; no, sir.

Q. Please tell us how you know it was not put in the bank?

A. Because I had instructions to take out $25 every day from the total receipts. I would bank the balance, with the Bank of America.

Q. Are you familiar with the various bank accounts that Mr. Rau had? [136]

A. He had an account for the Southern Wine and Liquor Company; he had an account for the French Cafe; he had an account for the Southern Hotel. He also had a personal account.

Q. At what bank did he have these accounts?

A. The Southern Bar, Southern Wine and Liquor Company, the French Cafe, and the Southern Hotel, I believe were all at the Bank of America. His personal account, I think, it was at the Anglo Bank. I am not positive of that.

He had a safe deposit at the Anglo Bank, Anglo, California Bank.

Q. Safe deposit, Anglo Bank?

A. Yes, sir.

Q. Mr. Webb, with respect to these bank accounts, did you have authority to draw checks on any of them? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Which ones?

A. Well, I signed the checks for the Southern Hotel, the Southern Wine and Liquor Company and the French Cafe.

Q. On the three accounts? A. Yes, sir.

Q. That was with the Bank of America?

A. Yes, sir. [137]

Q. You had authority to draw checks on those and for what purpose would you draw checks?

A. Pay bills, payroll.

Q. Pay for purchases? A. Yes, sir.

Q. You did the buying for the French Cafe?

A. The cafe was a little different operation than the Southern Bar. Practically everything from the French Cafe was paid by cash, outside of maybe buying, or order something, $150, $200 or maybe $100.

Everything in the Southern Wine and Liquor Company was paid by check, with the exception of maybe ice, maybe limes, oranges or little incidentals.

Q. Mr. Webb, I understand your testimony to be that you did not do any buying for the French Cafe, but that you did it for the bar in '45 and '46?

A. I said all the checks, if that is what you mean.

Q. For what purpose, sir?

A. If any bills were brought in, I made a check out or Miss Goldstein made the check out, I signed it. I had authority to sign all checks.

It is possible I might have bought something. I don't remember. I mean, it is——

(Testimony of Robert R. Webb.)

Q. Well, you actually did some buying for the French Cafe? [138]

A. I worked directly under Mr. Rau. He ordered me, might ask me to—I think there is one check in there for $3,500 that was made out to me, that I evidently cashed.

Q. What check is that now; what check are you talking about now?

A. Well, in my deposition, in the deposition taken in 1949, they asked me if I remember a check of $3,500, and I couldn't remember it, but I think I remember it now.

Q. They asked you in 1949? A. Yes, sir.

Q. About a $3,500 check?

A. I think it was 1942, the check was made out.

Q. To whom was the check made payable?

A. I believe it was made payable to me.

Q. Was that in 1945?

A. I believe it was in 1942.

Q. 1942. Now, suppose you tell us why that check was made payable to you in the amount of $3,500?

A. Well, Mr. Rau bought a house at 318 F Street, about that time, and on a Sunday morning a man came in and asked Mr. Rau if he wanted to buy his home at a very good price.

So, evidently the next day he gave me the—I think it must have been on a Monday, Mr. Rau must have made a check out to me to go to the bank and get the cash, [139] because the only way the deal could have been completed was to get the cash right now, because this—I think his name was Mongerson

(Testimony of Robert R. Webb.)

—he is in the electrical business in Bakersfield, wanted to get out of town right away.

Q. When Mr. Rau was buying this house, why would he issue the check to you, why didn't he issue the check to the seller?

A. Because he wanted his money right away, and evidently wanted me to go get it cashed, because Mr. Rau very rarely went to the Bank of America, himself.

Q. So, he wanted to handle it in that fashion?

A. He made it out to me, so I can go up without difficulty and get the money from the bank, and come back and give it to him, but I remember on Sunday morning, Mr. Mongerson came in and they made this deal for this house. Now, whether that was the same occasion, I am not positive.

Q. Well, instead of drawing the check to the seller and letting you go up to the bank and endorse the check, then it is your testimony that Mr. Rau did it in this particular fashion that he drew the check to you and you got the cash, by going to the bank and cashing the check, and then giving the cash to the seller?

A. I don't remember how the transaction worked out. The only thing I remember that I did have a check made out to me for $3,500, and it worried me because I didn't know [140] how to explain it.

It finally dawned on me, because I live in the house for five years, and it was 1942 before the real estate prices went up. That is, I know he got this, he

(Testimony of Robert R. Webb.)

bought the house right then, and Mr. Mongerson wanted to get out of town, as fast as he could.

Q. What was the man's name that sold the house? A. The name was Mongerson.

Q. Mongerson, Mongerson. He is in the electrical business? A. Yes.

Q. You gave him $3,500 in cash by cashing your check made payable to you?

A. As far as I know, that is what that check was for. I couldn't swear to that, but that is the only solution I have of it.

Q. Mr. Rau very seldom went to the bank?

A. Yes, sir.

Q. He had a personal bank account at that bank, did he not? You have already testified to that.

A. I would make the deposits for him, as a rule.

Q. You made the deposits for him?

A. Yes.

Q. In the Bank of America in his personal bank account? A. Yes, sir. [141]

Q. The reason that Mr. Rau did not go to the bank was because of his physical condition, Mr. Webb?

A. Mr. Rau, at the hotel, he could get around very fast. I mean, but out in the street——

Q. Very fast, did you say?

A. In the lobby, yes, sir, in the bar or any place, he could walk as good as anybody up until the last few months last year, year and a half. Then he would use a cane.

But he didn't like to go out on the street; when

(Testimony of Robert R. Webb.)

he went outside, he usually got in a car and he would drive.

The Court: Who would drive?

The Witness: Well, he would have a chauffeur. He wouldn't drive, himself.

Q. (By Mr. Simpson): A chauffeur?

A. A nurse or somebody would drive for him.

Q. A nurse? A. Probably a nurse.

Q. Who was his nurse?

A. Miss Dorsey. I think Betty Dorsey, I think was the last.

Q. Betty Dorsey?

A. Nurse that took care of him.

Q. Why did he have to require the services of a nurse? [142]

A. Well, as I say, he wasn't a well man. He wasn't—my personal opinion, his mind was as keen in 1945 and 1947 as it was in 1942.

Q. Just as keen in 1952?

A. But he had a hard time getting around.

Q. His mind was very keen in 1952, as well as 1949?

Mr. Gardner: Please, object to that question. There has been no showing that Mr. Webb, the witness here, even knew him or even saw him in 1952. The testimony is, all up to this time, has gone to the year 1947.

Mr. Simpson: He just said 1949.

The Witness: I meant 1942.

Mr. Simpson: He said 1949, now, he went beyond '47.

(Testimony of Robert R. Webb.)

The Court: Petitioner's Counsel may inquire.

Q. (By Mr. Simpson): Mind very keen in 1952, also, Mr. Webb?

A. 1952, I don't know whether he was even alive then. Let's see. The last I saw of Mr. Rau was probably in 1950, until he was——

Q. On what occasion was that, Mr. Webb; where did you see him?

A. I don't know whether it was up, uptown or I may have went out to his house. [143]

Q. What was his condition at that time?

A. His condition wasn't very well in 1950.

Q. Was he mentally sharp, fast?

A. In 1950 he wasn't very—I don't think he was. He looked like he didn't have too long to live.

Q. How old a man was he?

A. I don't know. I imagine around 70.

Q. When he died?

A. I think around, probably around 70 when he died, or 72. I don't know.

Q. You knew him very well, didn't you, Mr. Webb?

A. I didn't really get very personal. I didn't ask him his age or he never told me his age.

Q. You knew him in 1932, you knew him for 18 years, but you didn't know how old he was, is that it?

A. It didn't interest me how old he was. I may have known, but it didn't make an impression on me. I knew he was around 60, just the same as somebody would judge me around 60 or more.

(Testimony of Robert R. Webb.)

Q. You say he was 70 when he died?

A. I figured around 70, yes, sir.

The Court: When was the first time that he began using the services of a nurse regularly? What year, if you can state?

The Witness: I would say 1946. Mrs. Rau [144] died, I believe, in 1944 or '45. And it was sometime after that.

Q. (By Mr. Simpson): You knew Mrs. Rau very well, too, I assume? A. Very well, yes.

Q. She died in 1944, '45?

A. I think so, yes.

Q. Did you go to her funeral?

A. Yes, sir. I went to Mr. Rau's funeral, too.

Q. What funeral parlor, Mr. Webb?

A. Doughty, I think it was Doughty. I am not positive of that.

Q. In Bakersfield?

A. Yes. Doughty-Calhoun.

Q. Now, when you collected the receipts from these various businesses, like the ticket at the bar, you also collected them for the Southern Hotel, did you not? A. Yes, sir.

Q. And you also collected them from the French Cafe? A. Yes, sir.

Q. Is that correct?

A. Yes, sir; that is right.

Q. Did you personally put the currency in the bank?

A. Yes, sir. Every working day that I was there I did it.

(Testimony of Robert R. Webb.)

Q. Was any of this money ever deposited in your bank [145] account?

A. In whose bank account?

Q. In yours. A. No, sir.

Q. Do you have a personal account, Mr. Webb?

A. Yes, sir.

Q. At what bank?

A. Bank of America.

Q. Do you deposit your salary from that bank; I mean, from Mr. Rau, Mr. Rau's employment?

Mr. Gardner: If the Court please, I don't believe we have established a date as to this bank account. It is quite general. I took it that it was right now that he had the bank account.

Mr. Simpson: I will get to that.

Q. (By Mr. Simpson): Did you deposit your salary checks in that bank?

A. No, not necessarily. I might have cashed it right there at the hotel.

Q. Then what did you do, put in your bank account, currency?

A. Probably currency; yes, sir.

Q. Didn't put any checks in that bank account?

A. I may have. I don't recall any, particularly.

Q. Would they only be your salary [146] checks?

A. I don't believe. I may have put in salary checks. I don't remember.

Mr. Gardner: If the Court please, could we get it established as to what bank account we are talking about, and what years we are talking about?

(Testimony of Robert R. Webb.)

Mr. Simpson: I am talking about his personal banking account. I am asking him a general question.

The Court: I think we better fix——

Q. (By Mr. Simpson): From '42 through '47, all right, during that period, did you deposit your salary checks in that bank, personal account at the Bank of America? A. I don't remember.

The Court: Was that a checking account or savings account, Mr. Webb?

The Witness: Checking account.

Q. (By Mr. Simpson): Now, you do not remember whether or not you had deposited your salary checks, or whether or not you deposited currency in that personal bank account?

A. No, I don't.

The Court: There will be a short recess.

(Short recess.)

Q. (By Mr. Simpson): Mr. Webb, just before recess, we were discussing [147] I believe, Mr. Rau's personal bank account. You deposited in that account? A. Yes, sir.

Mr. Simpson: Mark this Petitioner's Exhibit No. 11 for identification.

The Clerk: Petitioner's Exhibit No. 11 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 11 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you

(Testimony of Robert R. Webb.)

Petitioner's Exhibit 11 for identification, and ask if this is the book of the personal bank account of Mr. Walter F. Rau in the Bank of America?

A. Yes, sir.

Q. I ask you to look at that bankbook, tell me whether or not the money that is deposited in that account, deposits for each of the years as indicated, were made by you, personally?

A. Not every account, because I wasn't there every day.

Q. You were not where every day?

A. I was not at the hotel every day. Somebody else might have made deposits. [148]

The Court: Did you make any of the deposits in that book?

The Witness: Yes, sir; yes, sir, most of them.

Q. (By Mr. Simpson): You made most of the deposits? A. I did.

Q. Were they in the form of cash, or were they check?

A. Some of them were checks, and some of them were cash.

Q. When you got the cash, from whom did you get the cash?

A. I would get it from Mr. Rau.

Q. When did you get it from Mr. Rau; what time of day did you get it from Mr. Rau?

A. There would be no special time, might be any time between—banking hours—any time from ten o'clock in the morning till three in the afternoon; no special time.

(Testimony of Robert R. Webb.)

Q. Did you give the cash to Mr. Rau that you took off the top?

A. The $10 from the restaurant from the French Cafe, I would put in an envelope each month, and the $25 a day I would put in an envelope, and mark it bar. At the end of the month it would be turned over to Mr. Rau. [149]

Q. How was it turned over to Mr. Rau, let's be specific? A. In cash.

Q. Let's be specific. Did you turn it over to Mr. Rau? A. Yes, sir.

Q. Now, did Mr. Rau give you the money, back to you, to put into the bank?

A. Sometimes he would give me money back, and sometimes he would wait till he got maybe a thousand dollars in cash, and get a thousand dollar bill.

Q. A thousand dollar bill? A. Yes, sir.

Q. Did you ever deposit a thousand dollar bill at the Bank of America?

A. No, but I have got him many of them from the Bank of America, for him.

Q. Now, when you got them from the Bank of America, do you know what Mr. Rau did with it?

A. He would put them in his safe deposit box, and at one time, I went to the bank with him, and he had $21,000 in bills, to my best recollection.

Q. Did you count them, the money?

A. No, he was with me. He went into the safety deposit box, himself. I stood outside, because I wasn't [150] permitted to go in with him.

Q. Did you ever go into that safety deposit box?

(Testimony of Robert R. Webb.)

A. No. I couldn't, didn't have authority to go into it.

Mr. Gardner: If the Court please, the witness was answering a question. I would like to request that he be allowed to answer the question.

The Court: Have you completed your answer?

The Witness: No, I haven't, sir.

The Court: You may complete it.

The Witness: The $20,000, he bought $20,000 worth of bonds, of war bonds.

Q. (By Mr. Simpson): In what year was that, Mr. Webb?

A. I don't remember the exact year.

Q. You do not remember the year?

A. No, sir.

Q. I asked you a question, whether or not you ever went into the safety deposit box?

A. No, I never did.

Q. I would now like to ask you, did you ever have an opportunity to see into the safety deposit box?

A. No; no, sir.

Q. Never?

A. I stood outside of the cage. [151]

Q. But you never, at any time, looked into that safety deposit box? A. No, sir.

Q. Then, how is it that you know that he deposited 20 one thousand dollar bills in those safety deposit boxes?

A. When he came out of the safety deposit box, he had the 20 one thousand dollar bills. He went to the cashier, went to one of the clerks at the bank, and bought $20,000 worth of war bonds.

(Testimony of Robert R. Webb.)

Q. Well then, now you know.

A. The ones that expire in 12 years. I believe they were.

Q. Well now, then you know that $20,000 was in the safety deposit box by virtue of the fact that you went to the bank with him, did not go into the lock box, stayed on the other side of the cage; he then goes up to a teller——

A. I went with him.

Q. You were with him? A. Yes, sir.

Q. And at that time, he puts out the money that you never counted, but you never counted it?

A. No, sir.

Q. Did he tell you that he bought the bonds or did you see him make the purchase? [152]

A. He told me that he made, and I watched the purchase.

Q. Did it ever come a time when he sold those bonds? A. I don't remember.

Q. You don't remember that?

A. I don't recall it, no.

Q. Did he ever tell you that he sold it?

A. He may have, but I don't recall that. Didn't interest me, you know, it was none of my business.

Mr. Simpson: If your Honor please, and with the consent of counsel, the respondent would like to introduce evidence on cross-examination, but if he has no objection, I would like to introduce Petitioner's Exhibit No. 11.

Mr. Gardner: I have not yet seen the petitioner's exhibit.

(Testimony of Robert R. Webb.)

Mr. Simpson: Well, I will let you see it.

Mr. Gardner: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked Petitioner's Exhibit No. 11 was received in evidence.)

The Court: In connection with the $10 a day that was put in an envelope, was there a separate envelope for each day?

The Witness: No, sir. [153]

The Court: It was just one envelope?

The Witness: One envelope; yes, sir.

The Court: And the $10 was added to that envelope so that at the end of the month that envelope would then contain either $300 or $310, depending upon the number of days in the——

The Witness: Yes, sir.

The Court: ——in the month?

The Witness: Yes, sir; yes, sir.

The Court: Is there any notation on the outside of that envelope; is there anything that distinguished that envelope from any other envelope?

The Witness: I would just mark on it French Cafe.

The Court: It was marked French Cafe?

The Witness: Yes.

The Court: Now, what about the amounts from the French Cafe, that were in excess of the $10 on week ends, or the days when there might be heavier business?

The Witness: That would be put in an envelope.

The Court: In another envelope?

(Testimony of Robert R. Webb.)

The Witness: Yes, sir.

The Court: Not the same one?

The Witness: No, no, sir.

The Court: Did that envelope bear any designation; did it have any marking on it? [154]

The Witness: I think I marked the date and the amount, the day of the month, and it was $100, $100.

The Court: Was there anything on the envelope that would indicate that that amount came from the French Cafe?

A. I would just put right on it, write on the envelope, French Cafe, and on the bar, would be just bar.

Q. (By Mr. Simpson): How often did you write French Cafe on the envelope? A. Once.

Q. Once. Well, I thought there was a special envelope that was always there. Judge Raum just asked you if you made an envelope every day, and you said no, and you wrote, would write French Cafe on it.

A. That was—you are talking about something else, I believe; I am talking about the $25. I put that all in one envelope. I would get one of these long envelopes, and write French Cafe on it.

Q. How often did you write?

A. I took out $100 today, I would put down, March 1, $100, and put the next $100, or whatever it was in the same envelope, until the end of the month.

Q. Until the end of the month. All right.

Now, let's explore this a little bit, Mr. Webb. [155]

(Testimony of Robert R. Webb.)

You said you put the money in an envelope, and then write French Cafe. Now, when did you write French Cafe on the envelope?

A. On the first time I put any money in there.

Q. Was that in 1942?

A. It could be in 1942, up to 1947.

Q. So, you had a special envelope now in 1942 with French Cafe written on it? A. Yes, sir.

Q. So you would not then write, as you have testified, when you put the money in, you didn't write French Cafe down when you put the money in the envelope? A. Oh, yes, yes, I did.

Q. You did? A. Yes, I did.

The Court: Well now——

The Witness: There is another thing.

The Court: Let's stick to the French Cafe, and not to the bar. There were two types of money that you got from the French Cafe, that you put in envelopes, as I understand it.

The Witness: Yes.

The Court: One was the $10 a day?

The Witness: Yes, sir.

The Court: And the other was the larger amount [156] that you might remove from the receipts on week ends, or on days when business was particularly heavy?

The Witness: That is correct, sir.

The Court: Now, as to the $10 a day, I understood your testimony to be that you had an envelope marked simply French Cafe?

The Witness: Yes, sir.

(Testimony of Robert R. Webb.)

The Court: And you would put $10 in that envelope every day?

The Witness: Yes, sir.

The Court: Now, as to the other amounts that is the larger amounts that were taken, that were taken out of the receipts on the days of particularly heavy business, you had another envelope that was also marked French Cafe, but on which you would enter the date and the amount of any amounts that you put in there?

The Witness: Yes, sir.

The Court: Is that correct?

The Witness: Yes, sir.

The Court: Now, when you took out the contents of that second envelope from time to time, would you destroy that envelope and start all over again with a new one?

The Witness: Yes, sir.

The Court: Now, is that true with respect to the daily $10 a day envelope? [157]

The Witness: Yes, sir.

The Court: You would start fresh with a new envelope whenever you would remove the contents for the purpose of giving it to Mr. Rau?

The Witness: Yes, sir.

The Court: Was there a similar practice with respect to the amounts of money taken out of the receipts of the bar?

The Witness: Yes, sir.

The Court: You had one envelope for the $25 a day?

(Testimony of Robert R. Webb.)

The Witness: Yes, sir.

The Court: And how was it designated on that envelope?

The Witness: There would be just bar, b-a-r.

The Court: Bar?

The Witness: Yes, sir.

The Court: Now, how about the larger amounts that were taken out of the receipts of the bar; was there a separate envelope for that?

The Witness: That would be put in another envelope.

The Court: Still another one?

The Witness: Yes, sir.

The Court: Now, what would be the designation [158] on that envelope?

The Witness: Mr. Rau, I would probably put on it.

The Court: Mr. Rau. Would there be dates and amounts on that envelope?

The Witness: Yes, sir. Sometimes Mr. Rau might take the money right there, and put it in his pocket, or have me bank it right that day. It all depended; we didn't have any set rules or anything. He carried, usually he carried a pretty large amount of money in his pocket at all times.

The Court: Whenever the contents of any particular envelope was removed, you would start all over again with a fresh envelope?

The Witness: Yes, sir.

Mr. Simpson: If your Honor please, I think

(Testimony of Robert R. Webb.)

that your cross-examination here is very clear to me, now, based——

The Court: It wasn't intended either as cross-examination or direct examination.

Mr. Simpson: I am sorry.

The Court: I am endeavoring to acquire the, obtain the facts from the witness in a situation that I thought was quite cloudy.

Mr. Simpson: As you have developed, if I understand [159] it correctly, he first testified that he had one envelope in 1942, in which was written French Cafe, and that he used throughout the period, that he never again had to write French Cafe on this large envelope.

The Court: I didn't understand anything one way or the other on that. And that is why I attempted to get the facts from him.

I found the testimony confusing on that, up until the point that I began to interrogate him, and the purpose of my interrogation was to clear up what I thought was a confused situation.

Mr. Simpson: Yes. Well, it is confusing to me still.

Now, I would like to ask the reporter to go back to the question that I asked, with respect to how often did he write French Cafe on the envelope. Now, that was at least five minutes ago.

Can you go back and get that question?

(Record read.)

The Court: Proceed, Mr. Simpson.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): Coming back, Mr. Webb, if you will, to the manner in which you gave the cash to Mr. Rau, I think you testified that it would be somewheres between ten o'clock in the morning, or at least during banking hours; [160] is that correct? A. Yes, sir; yes, sir.

Q. That he would take the money and you did not know what he would do with it, except you testified very clearly, your recollection was fine as to the amount of money in the safety deposit box, and what he did with the $20,000. A. Yes, sir.

Q. Now, in going to the bank, yourself, to make deposits, you took, I believe as you have testified, some checks and some cash, and you made most of the deposits in his personal banking account?

A. Yes, sir.

Q. That is correct, is it not?

A. Most of the deposits I made, yes, in his account; yes, sir.

Q. Did there ever come a time when you ever deposited any of the cash, yourself, in your personal banking account? A. No, sir.

Q. Did you ever make any deposits of $500 in your bank account?

A. I made one of $5,000.

Q. You made one of $5,000?

A. After the hotel closed, and I might have made another of $500, because I had nothing to do with the hotel, [161] had nothing to do with that money, that was from a different source.

Q. From a different source? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Would you mind explaining the source of the $5,000?

A. My own personal money, my wife's and myself.

Q. Your wife and yourself? A. Yes, sir.

Q. Your wife is employed?

A. She was employed from the day we were married until up to the present time; yes, sir.

Q. Now, suppose you explain, if you will, where that $5,000 was before you deposited in your bank, and before you answer that—I am sorry.

When did you make that deposit of $5,000?

A. In 1947.

Q. 1947. What month?

A. I don't know the exact month; probably in October or November.

Q. Up until the time that you made that $5,000 deposit in the bank, where had you kept the $5,000?

A. Well, I had war bonds. I had some money in safety deposit box. I had some money, my wife had an account with the Beverly Bank of California, I think, on Wilshire, Beverly and Wilshire. [162]

Q. And you purchased war bonds?

A. I got a cashier's check from that bank. I believe it was the day that Franklin D. Roosevelt was buried. I think that would be the date.

Q. Well, let's see if we can get into that a little bit more.

The $5,000 you put in the bank after the hotel closed, places the date sometime in 1947?

(Testimony of Robert R. Webb.)

A. That is right.

Q. Of the deposit. Up until the time that you made that deposit of this money, was in the form of war bonds? A. Part of it; yes, sir.

Q. Did you buy those war bonds?

A. I bought some, my wife bought some; yes, sir.

Q. Did you buy them from your salary?

A. No, from both our salaries. I had another source of income.

Q. You had another source of income?

A. Yes, sir.

Q. Please explain what that source was, Mr. Webb.

A. Well, about 1940, '41, about two years, I got a commission of five per cent of gross bets on horse racing.

Q. I am sorry, I was looking for something, and did not get that answer very clearly. Would you mind [163] repeating it. I am sorry.

A. I got a commission of five per cent on some bets that I took on horse racing.

Q. Where did you take the bets?

A. In Bakersfield.

Q. Where in Bakersfield?

A. At the Southern Hotel.

Q. Did you have a telephone?

A. I had the hotel telephone.

Q. Hotel telephone. So, you were making money by taking bets on horses. What was the post time, Mr. Webb?

(Testimony of Robert R. Webb.)

A. The post time, it all depended where the races were being raced, where the meet was.

Q. What tracks did you take bets?

A. Well, it could have been on eastern tracks, on Santa Anita, Delmar, tracks in San Francisco.

Q. You take bets on tracks at Laurel, Maryland? A. Beg pardon?

Q. Did you ever take any bets on races that were being run in Laurel, Maryland, Laurel?

A. I imagine so. I don't know exactly.

Q. Pimlico in Baltimore?

A. I imagine so.

Q. Can you name some other tracks in the east on which you took bets? [164]

A. Well, there is Aqueduct and Belmont.

Q. Where is Aqueduct?

A. Long Island, New York. Belmont Park.

Q. Belmont Park?

A. City of New York. And in Maryland.

Q. Ever take any on the Bowie, Maryland?

A. Beg pardon?

Q. Bowie Race Track?

A. It is possible; I don't recall.

Q. What would be the post time for those tracks in the east?

A. Well, you get your post time, our time out here would probably would get it around, maybe, ten o'clock in the morning.

Q. So, the post time in the east would be ten o'clock Pacific time here?

A. Yes, around that.

(Testimony of Robert R. Webb.)

Q. So, in order to take those bets, what time did you get down to the hotel?

A. Seven o'clock in the morning.

Q. Seven o'clock in the morning?

The Court: Let's fix the years that are involved here.

Mr. Simpson: I am going to do, cover that, your Honor. [165]

The Court: You cover it once, so we will know what years we are talking about.

Mr. Simpson: Yes.

Q. (By Mr. Simpson): Now, we have you coming in at seven o'clock in the morning, and taking bets on the tracks, races.

Did that occur in 1942?

A. I believe the years is about 1940 and '41, before the, we actually got into the war, about two years.

Q. And then you ceased taking bets after '41?

A. Yes, sir.

Q. And the money that you had made, this five per cent commission, was that the $5,000 that finds itself going into your bank account in 1947?

A. That is part of it.

Q. Now, Mr. Webb, are you familiar with horse racing percentages, with respect——

A. I bet on them once in awhile, $2 bettor strictly, you know.

Q. What is known as the gambler's percentage on winning the first place?

A. I had nothing to do with the betting. I would

(Testimony of Robert R. Webb.)

receive, I had one man in Bakersfield, he probably, might give me $200 a day or $300 a day. He would write it on the piece of paper. All I would do is call the bets in. Maybe [166] I have a few friends, local friends of mine to bet. I would get five per cent of the gross, regardless of whether the horse won or lost.

Q. Then you were quite busy, were you not?

A. No.

Q. From seven o'clock in the morning, up until ten o'clock when the post time, would you—one o'clock in the east, isn't that true?

A. No. Most of the bets were on for one man. He had a business in town and I would walk, back his alley, and he would have a piece of paper with the horses' names and the amounts.

I could call them in in two minutes. I would call as a race on hotel time to find out if a horse won or not, to give this information to this man. He would come into the lobby and maybe go out to the cocktail lounge, and have a drink, maybe take me out there, have a drink with him.

Q. Did you get your commission whether or not the horse either——

A. That is right, five per cent on the gross, regardless of whether the horse won or lost.

The Court: Five per cent of the gross what?

The Witness: Of the money that I received.

The Court: You mean the amount bet? [167]

The Witness: Yes, sir.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): How many, how much would get in a day?

A. I made as high as $15. Lot of days I don't think I would take in more than $300, any day.

Q. No more than $300 for one man, so you had one man betting $300 a day with you; is that it, Mr. Webb? A. He didn't bet it all, himself.

Q. Now, let's get it straight then. You said you took it all from one man?

A. I said I also had——

Q. How long did the—the Court Reporter can correct me——

A. I took some friends, from some friends, maybe give me $20.

Q. You didn't say that. That is the first time you said that.

The Court: I think the witness did state that he had other bets besides this one large source of bet.

Q. (By Mr. Simpson): Well, let's break it down then. How much did this one man bet with you now? A. He would bet up as high as $300.

Q. Every day?

A. Not every day, [168] no.

Q. Now, did you take any bets on the race tracks on the Pacific Coast? A. Did I take any?

Q. Yes.

A. I took the bets that I just told you about.

Q. But now about the race tracks out here?

A. Yes, the Delmar or Santa Anita.

Q. So that now when you are taking bets on the race tracks here, you were certainly taking the bets

(Testimony of Robert R. Webb.)

as early as ten o'clock in the morning on the tracks in the east; now by the time the races began out here, you were taking bets about post time out here in the west?

A. As a rule, there were very few bets; I did take some bets in the east, but very few, because they wouldn't get the information at that time they had books in Bakersfield that gave you the rundown on the race, all the information which you probably wouldn't get from the eastern tracks. So, most of the bets that I did receive were from California tracks.

Q. Now, that money that you won, or not that you won, or that you earned, you ceased your operation in 1941 and 1942?

A. It was around those years. I am not positive.

Q. Now, would you please explain why a man who spent $15 a day from bets on the side, who makes, commissions on [169] illegal business, would suddenly cease that operation in 1942?

A. Because somebody else cut in on me and got the bets.

Q. Somebody cut in on you? A. Yes.

Q. You testified about Mr. Rau's income that became very lucrative because of the Army camps. Counsel named them specifically, and almost their location.

Now, you though, you stop in 1942 when you have a nice business commission.

A. The business was taken away from me. I didn't want to stop.

(Testimony of Robert R. Webb.)

Q. Taken away from you. Now, you had no income then of that nature from 1942?

A. That is right.

Q. And during 1942, 1943, '44 and '45, you made, as you have testified, $100 a month?

A. Up to about 1945, I believe.

Q. Yes. $100 a month you said.

A. My wife was also working, too, you know.

Q. She works for the——

A. We saved $100 a month, many a month.

Q. You saved $100 a month, many a month?

A. Many a month we saved $100. I tried to save [170] $100 a month, but of course, you couldn't do it.

Q. She was employed for the State?

A. Employed by the Standard Oil Company, and the Bakersfield City School System.

Q. What was, what were the years in which she was employed by the Standard Oil Company?

A. She was employed from 1938 until about, let's see, until about 1945, I would say.

Q. And then she began working for?

A. The Bakersfield City School.

Q. In what capacity? A. As a clerk.

Q. As a clerk. How much was her salary, Mr. Webb?

A. Well, she was making around $300, and something. Now, I don't exactly—her salary was probably around $150 a month at that time.

Q. About $150 a month; yours was $100 a month. That was $250 a month and you had $40 rent to pay, you said.

(Testimony of Robert R. Webb.)

A. Practically nothing else.

Q. And you had nothing else?

A. We had a good many of our meals at the hotel. We lived at the hotel for pretty near a year, got room and board. Everything was furnished to me in the house, linens, everything. I didn't buy any dishes. Everything that was donated. In fact, we didn't buy any furniture. **[171]**

Q. When you went back to the bar at night time, to see some of your old cronies, friends, did you buy whiskey for them and treat them?

A. No, very rarely I would buy any drinks. I thought I was entitled to drink on the house.

Q. You mean on the house, you mean on Mr. Rau? A. That is right.

Q. That's the way it went?

A. Yes, I had many drinks.

Q. On the house. You mean it was on Mr. Rau, don't you?

A. Mr. Rau permitted to me, to take a drink any time I wanted.

Q. He was a very kind man, wasn't he, Mr. Webb, very kind hearted?

A. He was kind hearted in some ways; yes, sir.

Q. What do you mean in some ways?

A. Well, he wasn't giving anything away. I mean, as far as any money or anything like to, to speak of.

Q. But did he like to put his money to work?

A. He would let me have all the meals I want,

(Testimony of Robert R. Webb.)

and take me in and have a drink at any time, or permit me to have a drink at any time, or to buy a drink for anybody.

And as far as going up there, I didn't go up there too often, because I worked till seven o'clock, and at [172] night, and I couldn't stand it; when you work from seven to seven, you are not going to do too much running around.

Q. But you like to bet the horses and you like to go to the bar and have a drink or two?

A. Oh, I bet on the horses once in a while, $2 bettor, strictly.

Q. Never bet over $2?

A. Yes. I have been down at the track, maybe once a year. Friend of mine was manager of the Turf Club and he would give me, reserve a Turf Club seat, and——

Q. You go to the races?

A. About once a year, on my birthday. Usually about March 9, or around my birthday.

Q. How much whiskey would you say that you drank on Mr. Rau?

A. Well, in the afternoon, I would probably have at least two bourbon and sodas.

Q. Every afternoon?

A. Very rarely I missed; yes, sir.

Q. And——

A. Chances are I would go in with him, maybe somebody come in and take me in and buy me a drink. I might take somebody else in and buy him, buy them a drink. Which we considered good business.

(Testimony of Robert R. Webb.)

Q. Lot of people thought you were a nice man to have [173] around in Bakersfield, friendly, always get a drink when Mr. Webb was around. That was the general reputation that you had in Bakersfield, was it not? A. No, it wasn't.

Q. It wasn't? A. No.

Q. Now, Mr. Webb, you stated Mr. Rau wouldn't give anything away. He was frugal, was he?

A. Pardon?

Q. Frugal?

A. As far as money was concerned, he was a little bit close. He would give you all the drinks you wanted, all the meals you wanted.

Q. As far as money, he was very close?

A. If he were in it by himself, he would buy everybody drinks. He wouldn't let anybody buy him a drink?

Q. He was generous?

A. In that way; yes, sir.

Q. Very generous? And you say kindhearted?

A. Pardon?

Q. And kindhearted, too, you stated?

A. In some ways; yes, sir.

Q. Didn't he like to take his money and put it to work, and buy things with it, like hotels?

A. Yes, sir. He bought a hotel in Taft, that he paid, [174] I think $70,000 or $72,000. I am not sure of the exact amount.

Q. And he sold it? A. He sold it.

Q. Did he make money or lose money on it?

A. He lost money.

(Testimony of Robert R. Webb.)

Q. Very much?

A. I don't know how much, but I know it was a losing proposition. He didn't have it too long and he sold it for, I believe, about $42,000 or $41,000.

Q. Lost what, about $30,000 on it?

A. He called me up, he called me up to his room and he said, call up Taft, the people that had previously owned the hotel, and give it back to him, them, for $40,000.

So, I called them up and I said, "Well, I think I can get the place for you for $42,000." I knew $40,000 was too cheap. I told Mr. Rau, I was trying to get a bit more. He said, "Go ahead, get what you can."

So, I believe that, I am not sure, whether it was $41,000 or $42,000.

Q. Did you handle that deal for him?

A. I had the man come over and make the deal with Mr. Rau. I didn't have anything to do with the money or check or anything like that.

Q. Did you get a commission? [175]

A. Yes, he gave me, I think it was, $200.

Q. He gave you $200? A. $200, $250.

Q. How did he give it to you, cash or check?

A. I believe by check.

Q. What did you do with the check?

A. Probably cashed it. I don't know whether I deposited or cashed it.

Q. Now, you saw him take $20,000 out of a safety deposit box, and pay, buy bonds with it?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Twelve-year bonds? A. Yes, sir.

Q. They bore interest?

A. Interest, interest bonds.

Q. Interest bonds. Were they Treasury unregistered bonds, do you know?

A. Beg pardon?

Q. Were they Treasury bonds, unregistered bonds? A. I don't know.

Q. You know that they were bonds, though?

A. Yes, sir.

Q. Were they issued by the Federal Government, do you know?

A. Well, I imagine so, if they were Government bonds. [176]

Q. Well, they weren't some state bonds?

A. No, no, they were Government bonds.

Q. I want to establish that they were Federal bonds, Government bonds? A. Yes, sir.

Q. Now, he lost the $30,000 in the Taft Hotel. You knew about that, didn't you, when he lost it, because you were in it?

A. I knew that if he paid $70,000, settled for $40,000 or $42,000, he must have lost around $30,000.

I don't know how much money he made, when he was—how much money he lost when he was operating the hotel.

Q. Mr. Webb, you testified with respect to deposit of $5,000 in your bank account, you said it was some time in 1947. You placed it around October of '47.

(Testimony of Robert R. Webb.)

A. I am not sure of the date. I know it was 1947.

Q. Did you ever make any other deposits, similar to that? A. Yes, sir.

Q. Please state the circumstances under which you made that deposit, and designate the amount.

A. I went in business and I had to have $10,000. Then I had to have $12,000. So, I had some war bonds, personal part of war bonds that were given to me during the First World War. I cashed those in for around $350, [177] something like that.

I also had about $900 in the Investors Syndicate. I drew $1,100. I already had $1,100 cash.

Q. You borrowed $1100? A. Yes.

Q. From whom?

A. $600 from my brother, $200 from a man named Sullivan, very good friend of mine in Los Angeles, who has since died, and $300 from a Mary Emmons, long personal friends of mine.

Q. The war bonds that you purchased, were purchased when, Mr. Webb, again?

A. During the war years. I didn't purchase them all at once. I purchased maybe $100 now, $1,000 bond.

Q. How much did you have to pay for a thousand-dollar bond, $750? A. That is right.

Q. Did you go to the Bank of America to buy that bond?

A. Probably did. I bought them also from friends in Bakersfield. I don't remember.

Q. From friends. What kind of friends did you buy these bonds from, Mr. Webb?

(Testimony of Robert R. Webb.)

A. Well, I bought one bond from a school teacher's [178] son.

Q. War bonds?

A. War bonds, yes, sir, $1,000 bond from him.

Q. Do you realize that war bonds can't be sold in that fashion? A. Beg pardon?

Q. That war bonds could not be sold in that fashion?

A. I don't realize it, no. I know that he was taking, handling it. I don't know how it was handled. I haven't any idea.

Q. You don't know, have any idea?

A. If you want any proof, I can give you the man's, party's name.

Q. I would like to inquire, if the Court would take judicial notice, that war bonds are not transferrable, cannot be purchased in the manner testified to by the witness.

The Court: The Court is aware of the statutes that relate to the so-called E bonds, and I think there is an F series, as well. And my impression is that the law in relation to those bonds prevents the transfer of them.

However, the Court is also aware that during the war there were many drives for the sale of bonds, and that there were various organizations that spearheaded and participated in the drives, and I would not know from [179] this witness' testimony, whether the person that sold him the bond was simply participating in one of these drives as a salesman, or agent, or not.

(Testimony of Robert R. Webb.)

I think that it would be well to clarify it.

Was he selling his own bond to you?

The Witness: No. He was not selling his own.

The Court: Or was he simply participating in a war bond drive?

The Witness: Yes, sir.

The Court: As a salesman?

The Witness: Not transferred from, to me from him. It was a salesman deal. It was a drive. He sold them at theaters and every other place.

Q. (By Mr. Simpson): You didn't buy it from a friend, then you didn't mean to convey that you bought it from some friend, rather that you, that now you bought it from people whose—committees and so forth?

A. I didn't mean that. I meant that, personal, it wasn't his personal bond. It was one of these drives. The same as he sold in theaters or any other kind of a drive.

Q. Now then, this friend who may have been spearheading a drive for sale of war bonds, what was his name?

A. The school teacher's son, and I think her husband [180] was a doctor in Bakersfield, a dentist; I believe his name is Dr. Proctor, I believe.

Q. Proctor?

A. I am not positive that I have the right name or not.

Q. And how old was the son from whom——

A. The son was a young boy, probably 15, 16 years old.

(Testimony of Robert R. Webb.)

Q. Fifteen or 16?

A. But his mother came with him, come down to my house.

Q. You didn't buy the bond from the son, you bought it from the mother?

A. Well, the son was handling it. He was the one who got credit for selling them, anyway.

Q. He came down to your house?

A. With his mother. Who was a school teacher in Bakersfield.

Q. So, you gave him $750 cash at your home for the bond?

A. I don't know how it was bought, but I bought $1,000 bond for $750.

Q. Well, if you had accumulated money, was it in the form of checks or cash you were saving this money?

A. I saved some of the money at home. I put some [181] money in the safety deposit box. I didn't have any special way. I don't think there was any law how to handle it.

Q. Now, but this boy, when this boy came to your house that night, you had $750 cash to, with which to purchase, the cash?

A. I don't know, remember it. I may have paid him the next day. I don't remember just the whole incident.

Q. You don't remember that transaction at all then?

A. I remember the boy and his mother coming down to my house.

(Testimony of Robert R. Webb.)

Q. Yes.

A. She worked at the same school, the mother worked at the same school as my wife did, Lincoln School in Bakersfield.

Q. Now, let's get that name, because maybe we can find out exactly what happened, Mr. Webb.

A. All right.

Q. The name was what?

A. If I could ask, I am not sure. He is a dentist in Bakersfield. I think his name is Dr. Proctor or Dr. Pryor.

Q. Pryor? A. P-r-y-o-r; that is right.

Q. What was the boy's name, the son's name?

A. I don't know his first name. I don't even know [182] Mrs. Pryor's first name. She was a friend of my wife's.

Q. They are not close friends now?

A. I never was a close friend. My wife was a close friend of, business friend of Mrs. Pryor, who is a school teacher at the school that my wife worked at.

Q. But at no time did your wife ever mention Mrs. Pryor's first name?

A. Oh, maybe, but I don't recall it. I don't recall it. I didn't see enough of her or even think of it. I wasn't particularly interested in her.

Q. You weren't interested in the first name. It was a close friend of your wife's, but you don't know.

A. My wife has many close friends or business friends.

(Testimony of Robert R. Webb.)

Q. All right. We will dispense with that.

Now, let's go into this $12,000 that you had to go in business with. Is that the business of the French Cafe? A. Yes, sir.

Q. That you went into with Mr. Rau and Mr. Bender? A. Yes, sir.

Mr. Gardner: If the Court please, I would like to inquire as to whether or not you are going to interrogate this partner about a deceased partner?

Mr. Simpson: What do you mean by deceased partner? [183] I am not asking this question about his deceased partner.

Mr. Gardner: You are asking about the French Cafe; are you going into that? Is this the same thing that you were objecting to yesterday?

Mr. Simpson: You mean with respect to whether or not a surviving partner can testify against a deceased partner?

Mr. Gardner: Yes.

Mr. Simpson: Of course not. I have a surviving partner. We are not getting testimony against a deceased partner. I can elicit testimony favorable to a deceased partner, but not against him.

Mr. Gardner: I must object on the same grounds he objected yesterday, if the Court please.

The Court: His objection yesterday was not ruled upon, and I see no occasion at this point to rule upon any such objection. Proceed.

Q. (By Mr. Simpson): Did you become a partner with Mr. Bender in 1947? A. Yes, sir.

Q. Who else was a partner, if anyone, in 1947?

(Testimony of Robert R. Webb.)

A. Mr. Walter Rau, Sr.

Q. Now, you are in a partnership and operating under what name?

A. Under the French Cafe. [184]

Q. Where was the French Cafe located?

A. Located at Chester Avenue and 18th Street, Bakersfield, California.

Q. When was this partnership, consisting of you, Mr. Rau and Mr. Bender, formed?

A. Some time before the fall of 1947.

Q. And it is with respect to the formation of that partnership that you deposited some money in your bank account?

A. I had to deposit it to get—I don't know whether the attorneys got the money or whether it was given to—I guess to Mr. Bender, to give to the attorneys, but the attorneys were Kendall and Howell, that handled, I believe, the contract.

Q. Kendall and Howell?

The Court: Is this different from the French Cafe, that was in the hotel?

The Witness: Yes, sir.

The Court: This French Cafe was not in the hotel?

The Witness: Yes, sir.

Mr. Gardner: If the Court please, may I interrupt?

Mr. Simpson: Yes, you may.

Mr. Gardner: If the Court please, I am going to object to this line of cross-examination, as going beyond [185] the scope of the direct examination.

(Testimony of Robert R. Webb.)

Now, if he desires to take Mr. Webb as his witness, I would have no objection.

Mr. Simpson: If your Honor please, I think that the door is now open by his own testimony, with respect to the partnership, the fact that he even stated that he deposited money in the bank in connection with the formation of that partnership.

I now should be permitted to inquire into that.

Secondly, it seems to me——

Mr. Gardner: If the Court please, first, he did never testify that he deposited money of that partnership in the bank. The partnership he was referring to was the one you discussed with him, the French Cafe that was in the Southern Hotel. That was with Bender-Rau partnership.

Mr. Simpson: I am not inquiring into that. I am asking him about his interest in that partnership. That is what I am going into. Certainly has knowledge of that.

Mr. Gardner: I object to the question just asked by counsel, for the Petitioner, on the grounds that this goes beyond the scope of the direct examination, and I have no objection to eliciting information from this witness if he makes the witness his witness.

The Court: An exploration of the affairs of this new [186] partnership is certainly beyond the scope of the direct examination.

At the present time, however, I cannot tell whether some questions with respect to the new partnership may not have some bearing; unless

(Testimony of Robert R. Webb.)

counsel carries this too far, I will give him reasonable scope.

The present question may be answered.

Mr. Simpson: Thank you, your Honor.

Q. (By Mr. Simpson): Going back, Mr. Webb, again, you have testified that you became a partner with Mr. Bender and Mr. Walter F. Rau, Sr., in 1947? A. That is right.

Q. That in that connection you deposited some money in your bank account and that you also testified, if I remember correctly, that it required $12,000.

What would be the purpose of—or, strike that.

In your becoming a partner, what were you required to contribute to the partnership?

A. Altogether, the contribution was $13,500. I put in $12,000 and they needed more money. I took out, I paid them $100 a month for 15 months, because I didn't have the money, and I couldn't borrow any more money.

I drew $300 a month from the restaurant. Out of that, I paid $100 a month for 15 months. [187]

Q. Now—— A. I also paid——

Q. How much did you actually put in out of your own? A. $12,000.

Q. $12,000 of your own money, now, into that partnership in '47? A. Yes, sir.

Q. The one we just referred to, the source of your money was from war bonds?

A. War bonds, cash, some money in the bank.

Q. You deposited cash in the bank?

(Testimony of Robert R. Webb.)

A. I believe the money was all deposited in the Bank of America. So, I gave them a check for the full amount.

Mr. Gardner: May I approach the bench, your Honor?

The Court: You may; counsel may accompany you.

Mr. Simpson: If your Honor please, I have to apologize for this delay. I have some information.

The Court: Take your time.

Mr. Simpson: I thought collated, but I see that it isn't.

Would you please mark these 12 sheets as Petitioner's Exhibit 12 for identification.

The Clerk: Petitioner's Exhibit No. 12 marked for identification. [188]

(The document above referred to was marked Petitioner's Exhibit No. 12 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit 12 for identification, purporting to be bank statements of your account in the Bank of America. I am asking you to look at that for the purpose of refreshing your recollection.

A. I don't remember.

Q. Would you please look at this?

A. November, 1947.

Q. The ledger for May of '47, running through June 14 of '47, look at the deposits listed therein.

Would you read the deposits, sir?

(Testimony of Robert R. Webb.)

A. Let's see. 3665. I don't know whether that is $2.33——

Q. Are you reading the deposits?

A. Oh, $1,200.

Q. The next deposit, sir. A. $15.

Q. The next deposit, sir. A. $916.

Q. The next deposit.

A. And 83 cents. [189]

Q. The next deposit. A. $36. $3,600——

Q. Read that right there.

A. $3,600. I don't know whether it is $80 or——

Q. What is this deposit here, this next one?

A. $50.

Q. $50? A. $5,000 and $1,000.

Q. I believe that that will total roughly, if you follow me, as we go through it, $1200; isn't that correct, $15 is $1215, $916, that is $1231, $2131, correct, $2600, roughly $4700, $5,000.

Mr. Gardner: If the Court please——

Q. (By Mr. Simpson): $9,700, isn't that correct, sir? A. Yes.

Q. $5,000, $1,000.

Mr. Gardner: I object to that question.

The Witness: The whole deposits were $1,000.

Mr. Gardner: Just a minute.

The Court: The transcript is going to be very confusing. I have been following with my eye, the figures on the sheet with respect to which the witness has been interrogated, with the oral recital of figures.

Mr. Simpson: I agree. [190]

(Testimony of Robert R. Webb.)

The Court: When reduced on the transcript, will be wholly confusing without having that sheet before the reader.

Mr. Gardner: Well, it is my position, if the Court please, that is going to be wholely confusing in any event, having the sheet in front of the reader.

The question, itself, was relating to additions of columns here, figures that the witness obviously couldn't read, and I object to the entire question. Move that it be stricken.

The Court: I will let it stand.

Are you proposing to offer this exhibit in evidence?

Mr. Simpson: Yes, with consent of counsel on cross-examination, or I will introduce this in evidence as Petitioner's Exhibit 12.

Mr. Gardner: I haven't yet had an opportunity to see it.

Mr. Simpson: I thought you had seen it.

Mr. Gardner: I don't know the purpose of the document being offered as an exhibit, your Honor, but I would have no objection to a clear photostatic copy. I do object to this particular photostatic copy, in that it is—I don't believe anybody can read it.

I think it would have no value whatsoever, and for [191] that reason, I do object.

The Court: What is the purpose of the evidence, with respect to these items?

Mr. Simpson: The purpose of impeachment of this witness, and also to trace the source of funds

(Testimony of Robert R. Webb.)

which this witness has attributed to Mr. Rau over and above certain known figures.

The Government has pursued this line and now, in order for me to meet it, I am compelled to impeach this witness, and also to show that the money which they contend went to Mr. Rau, in fact did not go to him.

Mr. Gardner: Might I also ask, does this also reduce the net worth of the Petitioner, the Petitioner decedent?

Mr. Simpson: If your Honor please, with respect to whether it reduces the net worth, I can only say that we have stipulated the net worth. We agreed in chambers that we would be bound by the assets and liabilities contained in there; even inserted the worth, so there would be no question.

So, I am not proposing in any way at all to alter the net worth. This information does not alter it. It meets the Government's position that they weren't conceding a deficiency on the net worth, and he made very clearly to this Court on three occasions, he said that he [192] had stipulated deficiency. I did not mean that, I said, we stipulated to a net worth.

He is not bound by the net worth. He says he now is going into specific items. He, himself, has opened this up for the Petitioner.

Therefore, we should be permitted to pursue it, particularly the testimony against a deceased person.

The Court: I don't understand everything you said, Mr. Simpson.

(Testimony of Robert R. Webb.)

Mr. Simpson: I am sorry. I probably spoke too fast.

I will try to put it this way.

The Court: I understood the Government's counsel's position to be that the deficiency was not based on the net worth statement, that it was based on specific items, and that the only purpose of the net worth statement was to furnish such corroboration as might be met, come from such a net worth statement. It was confirmatory and that is all.

Am I correct in the interpreting of what you said, Mr. Gardner?

Mr. Gardner: That is exactly what I intended to state, your Honor.

Mr. Simpson: Well, your Honor, I understood him to say that, also that is not—I have no quarrel with [193] that. He was objecting to this, because he wanted to know if it varied the net worth, and I said we had already agreed to the net worth. It has been stipulated to.

The Court: And your answer to that is, no, that you are——

Mr. Simpson: The answer is no.

The Court: Not to vary the net worth statement. Very well. I took note that the proposed photostatic copy is not very clear, but I will admit it.

Mr. Simpson: If your Honor please—well, all right. I was going to say——

The Court: I made a statement at the beginning of this calendar that I do not like photostatic copies,

(Testimony of Robert R. Webb.)

particularly where they are unclear, such as the particular page that, which you have been interrogating this witness on. That was the page dealing with the beginning, with May 24 and going through to what seems to be June 14, 1947.

Mr. Simpson: I perhaps can cure that by having the bank—I have subpoenaed the bank, the officer, to bring down the originals.

The Court: I think it is reasonably satisfactory, but it is not good.

Mr. Gardner: I can't read it, your Honor.

The Court: I think I can make it out. [194]

(The document heretofore marked as Petitioner's Exhibit No. 12 for identification, was received in evidence.)

The Court: We will reconvene at 2:00 o'clock.

(Whereupon, the hearing in the above-entitled matter, was recessed at 12:35 o'clock a.m., until 2:00 o'clock p.m., the same day.) [195]

Afternoon Session—2:00 P.M.

ROBERT R. WEBB

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Cross-Examination

(Continued)

By Mr. Simpson:

Q. Mr. Webb, when we adjourned for lunch, we were going into the question of your bank deposits.

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. The source of the funds for those deposits. You testified that you had saved some money. I believe you purchased war bonds for the purpose of making deposits that you talked about in 1947, or not for the purpose of it, but rather that it was the source of the funds in which you made your bank deposits in 1947, and that particular year you became a one-third partner with Mr. Rau and Mr. Bender. A. Yes, sir.

Q. Did you put cash into that venture?

A. I put $12,000 altogether in it.

Q. In what form did it take, cash or check?

A. Well, I put the money, deposited in the bank at different times, so I had at least $12,000. I believe I wrote a, must have wrote a check out for $12,000.

That was, well, I had to put into the business to get in. [196]

Q. So you wrote a check out for $12,000 to get into that business?

A. As far as I know, I wrote the check out. I don't know whether all at one time or not.

Q. Would you recall the transaction as large as $12,000, whether or not you wrote a check for that amount?

A. I am not sure whether I wrote it out for $12,000. I might have wrote it out in two checks, or three checks.

Q. I think it is Petitioner's Exhibit 12.

The partnership was formed in 1947, in what month?

(Testimony of Robert R. Webb.)

A. That is right.

Q. What month?

A. Well, we started August, probably in October, I should say.

Q. In October?

A. I am not sure of the exact month, whether it was October or November.

We were working on it from the day that the Southern Hotel was demolished, we worked on this other lease.

Q. So that I understand your testimony, you put the $12,000 in——

A. When I went in, when we opened the French Cafe, I had $12,000 in the business. Now, just how I put it in, [197] how I wrote the check, or when I wrote the check, I don't remember.

The Court: Are you sure that you wrote a check?

The Witness: I had to write a check, sir, to get into the business.

Q. (By Mr. Simpson): Now, would the partnership books reflect the dates on which you made these contributions to the partnership?

A. They should.

Q. Did you ever see the partnership books?

Did you see the partnership books at any time, Mr. Webb?

A. I saw them at that time, but I don't remember the occasion or just how they were drawn up. They were drawn up as a three-way partnership.

Q. You kept that money in some form for a

(Testimony of Robert R. Webb.)

period of five years; did you, and then you put it in the bank? A. Yes, maybe longer than that.

Q. Mr. Webb, are you familiar with Mr. Rau's handwriting? A. Yes, sir.

Mr. Simpson: Five checks here, we can make it one exhibit, yes?

The Clerk: Petitioner's Exhibit No. 13 marked for identification. [198]

(The document above referred to was marked Petitioner's Exhibit No. 13 for identification.)

Mr. Gardner: I wonder if I might see those, Mr. Simpson?

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit No. 13 for identification, and ask you to look at the signature of the drawer of the check, and ask you if you can identify that signature? A. That is Mr. Rau's signature.

Q. That is check No. 66 of Exhibit 13 for identification, dated July 1, 1946.

Look at the next check in that series, being check No. 222, in the amount of $4,000, dated December 16, 1946, and look at the signature of the drawer.

I ask you if you can identify that signature?

A. I can. That is Mr. Rau's signature.

Q. Ask you to look at check No. 119, dated April 7, 1947, in the amount of $68.50.

A. That is Mr. Rau's signature.

Q. I ask you to look at check No. 805, dated May 2, 1947, for $29.36, and drawn in the Southern

(Testimony of Robert R. Webb.)

Wine and Liquor Company, and ask you if you can identify the signature [199] of the drawer?

A. That is Mr. Rau's signature.

Q. I ask you to look at check No. 172, dated July 9, 1947, in the amount of $649.60, and ask you if you can identify the signature?

A. That is Mr. Rau's signature.

Mr. Simpson: At this time, your Honor, I would like to introduce in evidence these five checks just identified by the witness.

Mr. Gardner: I object. There has been no showing that they are material to the issues in this case. I don't think there has been any proper foundation laid.

I object to their being admitted at the present time. All I can see that they will do is clutter up the evidence.

The Court: What is the purpose of the offer, Mr. Simpson?

Mr. Simpson: If your Honor please, I would like to offer these now on the condition that if I do not tie it in subsequent, it would be subject to a motion to strike.

The Court: It will be admitted conditionally.

(The document heretofore marked for identification as Petitioner's Exhibit No. 13, was received in evidence.) [200]

Mr. Simpson: Five more checks.

The Clerk: Petitioner's Exhibit No. 14 marked for identification.

(Testimony of Robert R. Webb.)

(The documents above referred to were marked Petitioner's Exhibit No. 14 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I show you Petitioner's Exhibit 14 for identification, and ask you to look at check No. 753, the series of that exhibit, and ask if that is your signature appearing on the face thereof? A. Yes, it is.

Q. And that check is for $1,000, dated April 7, 1947, check No. 753? That is your signature?

A. Yes, sir.

Q. I ask you to look at check No. 806, dated May 2, 1947, in the amount of $1,000, and ask if that is your signature as drawer of the check?

A. That is my signature.

Q. I ask you to look at check No. 917, dated July 7, 1947, in the amount of $3,500, drawn in the Southern Wine and Liquor Company, and ask if that is your signature as drawer of the check?

A. That is my signature.

Q. I ask you to look at check No. 10, dated June 3, [201] 1946, in the amount of $600 and ask if the signature of the drawer is yourself?

A. That is my check; yes, sir.

Q. That is "my check," or "my signature"?

A. My signature.

Q. I ask you to look at check 319, dated November 1, 1946, in the amount of $1,200, and ask if you can identify your signature as drawer of the check?

A. That is my signature.

(Testimony of Robert R. Webb.)

Q. Now, I ask you to look at the endorsement on the check No. 753, dated April 7, 1947, W. F. Rau, and ask if that is his signature?

A. That is not his signature.

Q. I ask you to look at check No. 806, look at the endorsement of W. F. Rau, Sr., and ask if that is his own endorsement?

A. That is not his endorsement.

Q. I ask you to look at the endorsement on check No. 917, W. F. Rau, and ask if that is his endorsement?

A. That is not his endorsement.

Q. I ask you to look at endorsement on check No. 10, signed W. F. Rau.

A. That is not his endorsement.

Q. Finally, I ask you to look at check 319, with the endorsement thereon, and ask if that is his own endorsement? [202]

A. That is not his endorsement.

Q. Now, Mr. Webb, check No. 753, is made payable to W. F. Rau; is that his signature?

A. No, sir.

Q. You have already acknowledged the signatures of drawer of the check.

A. That is my signature.

Q. The endorsement on the reverse of that check, W. F. Rau, you have testified is not his signature?

A. That is not his signature.

Q. Who put his signature there, if you know?

A. I did.

(Testimony of Robert R. Webb.)

Q. Please explain the circumstances for your endorsing Mr. Rau's signature on that check?

A. Mr. Rau would have me make out a check at different times to get cash, for me to go to the bank, and endorse his signature, because he didn't like the—the reason he had me sign all his checks, because he didn't want to sign checks.

Q. He didn't want to sign the checks?

A. So he would have me go to the bank and get the money, and I would bring it back to him.

Q. The check No. 806 for $1,000, made payable to W. F. Rau, is that his handwriting?

A. No, sir. [203]

Q. That is yours? A. That is mine.

Q. This is your signature? A. Yes, sir.

The Court: Will you point—you pointed to some writing and said this is, and inquired whether this is your signature.

Mr. Simpson: That is true.

The Court: You were pointing to the words that read Robert?

Mr. Simpson: R. Webb.

The Court: Webb.

Mr. Simpson: Robert Webb.

Q. (By Mr. Simpson): In other words, that is your signature as the drawer of the check?

A. Yes, sir.

Q. The purpose for your endorsing Mr. Rau's signature on the reverse of the check No. 806 is what, Mr. Webb?

(Testimony of Robert R. Webb.)

A. Mr. Rau would have me go up and get him so much money from the bank, draw it out.

Q. Does that explanation hold true also with respect to check for $3,500? A. Yes, sir. [204]

Q. $612? A. Yes, sir.

Mr. Simpson: At this time, your Honor, I offer in evidence Petitioner's Exhibit 14.

Mr. Gardner: I object on the grounds that the petitioner has not presented a proper foundation for the introduction of this evidence; he has not shown that it is material to the issues in this case.

The Court: Do you expect to tie them in?

Mr. Simpson: Yes, I expect to tie them in.

The Court: I will admit the exhibit.

(The document heretofore marked for identification as Petitioner's Exhibit 14, was received in evidence.)

Q. (By Mr. Simpson): Mr. Webb——

If your Honor please, as soon as you are through with that——

Mr. Webb, did you have authority to draw on the bank account of Southern Wine and Liquor account at the Bank of America?

A. I signed all the checks, practically all of them.

Q. I ask you, did you have authority to draw on that account in the Bank of America, Southern Wine and Liquor? [205]

A. I had the same authority as I had with those other checks.

(Testimony of Robert R. Webb.)

Q. Can I get a responsive answer from you, Mr. Webb; did you have the authority to draw on the bank account of the Bank of America for Southern Wine and Liquor Company?

Mr. Gardner: If the Court please, I am not sure that I understand.

The Witness: I don't really understand the question.

Mr. Gardner: He was asked this same question previously, and he stated that he did sign the checks.

Now, I don't know what counsel wants from this question, myself, and I certainly don't know that the witness can answer unless he does understand the question.

I think it should be rephrased.

The Court: Did you sign these checks with the authorization of Mr. Rau?

The Witness: Yes, sir.

The Court: He instructed you so to do?

The Witness: Yes, sir.

Q. (By Mr. Simpson): I will be more specific, was there authority at the bank whereby they would acknowledge check drawn by you in your name on the account maintained in the Bank of America for the Southern Wine and Liquor Company? [206]

A. Yes, sir, there was.

Q. You had the authority to draw a check on that account? A. On all accounts.

Q. Did you, Mr. Webb, on all of them? That would include the French Cafe, account at the

(Testimony of Robert R. Webb.)

Anglo, California, at the Anglo, California, in the bank? A. Yes, sir.

Q. You had the authority to draw on that account, did you?

A. I don't remember the Anglo, whether I—I must have had the authority, otherwise, they wouldn't have cashed them. I don't remember the——

Q. Then I would like to inquire of you, Mr. Webb, if you already had the authority to draw a check, why was it necessary in these five instances for you to write the name of W. F. Rau as payee, yourself as drawer, and then endorse in your handwriting the signature of W. F. Rau, in order to get this cash that you say that you gave to Mr. Rau, if you already had the authority to—why did you do it, in this fashion, explain it?

A. Well, it happened many more times, probably, than this. He was, send me up many times for me to write a check and go up and cash it for him, and I would give him the cash. [207]

That isn't all the checks that I probably signed. He never went to the bank; very rarely he would go to the bank, himself.

Q. Are you now saying that there are many more checks in which you endorsed Mr. Rau's signature? A. There could be.

Q. On an account in which you already had the authority to draw?

A. Yes. The bank would recognize my signature.

(Testimony of Robert R. Webb.)

Q. Could not you have gone to that bank on your own signature and drawn the money?

A. Not without Mr. Rau knowing about it, I couldn't.

Q. Not without his knowing about it? Would you please explain to me how Mr. Rau knew about these five checks you have testified?

A. He would ask me to go up and get—that is probably for a thousand-dollar bill. I don't remember what the occasion was, but it could be a thousand-dollar bill.

Many times I would go up, because he would never go to the bank, himself.

Q. Would he ever go to the bank, himself?

A. Very rarely. I don't remember him going to the Bank of America, going—I would go into the Anglo Bank with him, because he had a safety deposit box there. I [208] may have gone in with him. I don't remember.

Q. Where did you have your safety deposit box?

A. In the Bank of America.

Q. And he had his at the Anglo Bank, Mr. Rau did? A. That is right.

Q. Yours was at the Bank of America?

A. Yes. I did business with the Bank of America. I was there every day, sometimes three and four times a day, making deposits or something like that. He would ask me to make out a check; I had authority to sign all checks.

Q. Yes.

(Testimony of Robert R. Webb.)

A Bring the money back to him

Q. Couldn't you have drawn it out to Mr. Webb, or cash—I mean, draw it out to cash and sign it, and get the money; could you not have done that?

A. Yes, I probably could.

Q. I want to ask you, did you ever do it in that way? A. I don't remember.

Q. Did you ever draw a check to cash on an account which you had authority to draw, sign it as drawer? A. Yes, sir.

Q. And obtain the cash? A. Yes, sir.

Q. Then I would like to get this in the record. Now, [209] why, you wrote Mr. Rau's name as payee, signed your name as drawer, and then endorsed Mr. Rau's signature in a way that bears some similiarity between that and Exhibit 13?

A. Well, the bank never questioned my—I was in there two, three times a day—they never questioned anything like it.

Q. They never questioned anything like it, so you thought it was all right to draw the money out?

A. I do it on Mr. Rau's orders.

Q. On his orders?

A. Mr. Rau didn't like to write, himself. He was a little bit shaky. So he would ask me to make the whole check out and go up there. I probably made plenty of checks out for cash and brought the money back to him.

Q. Yes. Just a minute, Mr. Webb.

A. Sure.

(Testimony of Robert R. Webb.)

Mr. Simpson: May I have, just have a few moments, your Honor?

Q. (By Mr. Simpson): Mr. Webb——

The Court: Do you have them identified?

Mr. Simpson: That is 15.

The Clerk: Petitioner's Exhibit No. 15 marked for identification. [210]

(The document above referred to was marked Petitioner's Exhibit No. 15 for identification.)

Mr. Simpson: The reason why I wasn't going to do it in the beginning, your Honor, we have many more. I just wanted to show him this and ask him if it was——

Q. (By Mr. Simpson): Mr. Webb, I show you Petitioner's Exhibit 15 for identification, being four checks, and ask if that is your signature appearing on the face thereof, on check No. 751?

A. That is my signature.

Q. I ask you to look at check No. 709 on the face thereof, is that your signature?

A. That is my signature.

Q. I ask you to look at check 172, and ask if that is your signature as the drawer?

A. That is my signature.

Q. Check No. 1146, and ask if that is your signature? A. That is my signature.

Q. As the drawer. These four checks were on the Southern Wine and Liquor Company account; is that correct, Mr. Webb? A. Yes, sir.

Q. In the Bank of America? [211]

(Testimony of Robert R. Webb.)

A. Yes, sir.

Q. Now, all four checks are written to the order of cash; is that correct? A. Yes, sir.

Q. I ask you to look at the reverse side of the check, and see if there is any endorsement on those checks? A. No endorsement, no, sir.

Q. No endorsement. Now then——

If your Honor please, I now offer in evidence Petitioner's Exhibit 15, just identified by this witness, as to his signatures.

Mr. Gardner: I haven't had an opportunity to look at them.

Mr. Simpson: Here, we will let you look at them. I thought you were watching me.

Mr. Gardner: I have the same objection to this exhibit, as I had to the prior exhibits. I do not believe that a proper foundation has been laid for the introduction of this evidence at this time.

The Court: I will admit the exhibit; if it is not tied in, it may either be stricken or I will, in any event, give it no weight unless in some fashion or other it is tied in with the case.

The Clerk: Petitioner's Exhibit 15 is admitted in evidence. [212]

(The document heretofore marked for identification as Petitioner's Exhibit No. 15, was received in evidence.)

The Clerk: Petitioner's Exhibit No. 16 marked for identification.

(Testimony of Robert R. Webb.)

(The document above referred to was marked Petitioner's Exhibit No. 16 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit 16 for identification, and ask if that is your signature appearing thereon as drawer of the check?

A. That is my signature.

Q. In the amount of $1200? A. Yes, sir.

Q. Dated May 2, 1947. I ask you to look at the reverse thereof, and ask if that is endorsed on that check? A. My endorsement.

Q. In other words, your endorsement written as what? A. W. F. Rau, Sr.

Q. Is that the way you ordinarily write, Mr. Webb?

A. Same as this. I might have written it any way.

Q. What is the answer?

A. Yes, this is the way I write.

Q. This is the way you write, in other words, there [213] is a definite similarity between your signature as drawer and the endorsement of W. F. Rau, Sr.? A. That is my writing.

Q. Mr. Rau didn't endorse his signature?

A. No, sir, he didn't.

Q. Did not. Now, that check is drawn on the Anglo Bank, Anglo, California National Bank, the French Cafe account. Did you have authority to draw on that account? A. Yes, sir.

Q. You did. Then please explain the circum-

(Testimony of Robert R. Webb.)

stances under which you endorsed Mr. Rau's signature on the reverse thereof?

A. Well, it was the same situation as these other checks. You have me—he would have me make out a check, and go down to the bank and get the money for him. He looks at these checks every day. I don't know how I could possibly check, cash a check for that much. He also had a bookkeeper to check them.

Q. Mr. Webb, I hand you Petitioner's Exhibit No. 12, which is in evidence, and ask you to look at the date of May 27 in your personal bank account, and please read the amount of the deposit?

A. $1,200.

Q. Will you state whether or not that is this check of $1200 drawn on the French Cafe, the Anglo California [214] National Bank, that was deposited in the, your personal bank account?

A. Probably is, probably my part payment on the new business we were in.

Q. On the new business? A. Yes.

Q. Isn't it your testimony that this was the way in which you got cash for Mr. Rau, by doing what you did on this check?

A. I don't remember the case, the time of the check, when I wrote it, but all I know, I had to get $12,000 into the bank, give that cash to Mr. Rau, is all I can think of.

Q. It wasn't deposited in your bank account?

A. Altogether, I deposited around $12,000 in my account to get into that business.

Mr. Simpson: If your Honor, I offer in evidence

(Testimony of Robert R. Webb.)

Petitioner's Exhibit 16 just testified to by this witness.

The Court: I will admit Exhibit 16, but I would like some further clarification from the witness about this.

Exhibit 16 was a check drawn on the French Cafe at 1909 Chester Avenue—that was the old French Cafe, was it not?

The Witness: Yes, sir. [215]

The Court: What right would you have to the $1200, yourself?

The Witness: The only right I could figure that I gave him the $1200, made the check out and gave it to him.

The Court: That is, you gave him $1200 in cash?

The Witness: I don't remember the case, but I know I couldn't possibly have cashed a check for $1200 if it wasn't his orders. He never gave me any $1200.

The Court: Did you take $1200 out of the French Cafe for your own purposes?

The Witness: No, sir.

The Court: In response to a question of Mr. Simpson, however, you testified that, referring to Exhibit 12, and a deposit in your account of $1200 on May 27, that that deposit may have come from this check dated May 2.

The Witness: It could have.

The Court: Now, the inference from that would be that you were taking money out of Mr. Rau's French Cafe and putting it in your own personal

(Testimony of Robert R. Webb.)

account. If that were so, I would like to have you explain it and explain why.

The Witness: I never took any money out of any one of Mr. Rau's accounts, for my own purposes. I don't exactly remember that, but that might have been the time we were getting ready to go in the business, because I went up, got [216] the money and gave it to Mr. Rau. Whether Mr. Rau accepted all the money for the partnership, I don't remember that.

But I cashed many a check for Mr. Rau.

The Court: This was Exhibit 16, dated May 2, the perforations on it indicate that it was cashed on May 2.

The Witness: Yes, sir. The only thing——

The Court: If that $1200 did go into your account on May 27, what would you have been doing with the money in between those, those 25 intervening days?

The Witness: This is the 27th, and that is the 2nd.

The Court: Yes.

The Witness: Well, that is a different deal then, altogether. This is probably money that I went up with all these other checks, $3500 check and all these others, that he would have me cash for him. I couldn't possibly go up and cash a $1200 in my pocket, without him knowing it.

Mr. Simpson: Would you please——

The Court: Then is it your best judgment now

(Testimony of Robert R. Webb.)

that the $1200 entry on Exhibit 12 for May 27 does not tie in with the check shown in Exhibit 16?

The Witness: Yes, sir.

Q. (By Mr. Simpson): [217] Now, in order to clarify this testimony with respect to these checks, I want the record to reflect it clearly, if I understand your testimony correctly, you took checks to the Bank of America for the purpose of getting cash on some occasions for Mr. Rau?

A. On all occasions; yes, sir.

Q. On all occasions? A. Yes, sir.

Q. You had the authority to draw on the various bank accounts? A. Yes, sir.

Q. Without having to go to Mr. Rau, if you so desired, you could have simply drawn a check to cash, signed it as drawer and obtained the cash from the bank? A. Yes, sir.

Q. Now, that appears in Exhibit 15, where there are checks to cash, one for $755, one for $300, one for $1,000, and one for $615, none of which bear the name W. F. Rau thereon, either as payee, drawer or endorser.

A. There will be plenty more of them.

Q. Yes. You were then able to get the cash for Mr. Rau in this fashion as set forth in Petitioner's Exhibit 15; is that correct? A. Yes, sir.

Q. Now, let's look at Petitioner's Exhibit 14, there [218] are three checks in that exhibit, drawn on the Bank of America for the Southern Wine and Liquor Company for which you had authority to draw? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Payable to W. F. Rau, signed by Robert Webb, bearing the endorsement W. F. Rau, which you have admitted is not his endorsement at all?

A. That is right.

Q. The same is true with respect to two remaining checks in that exhibit on the French Cafe, on the Anglo California National Bank, in which the name W. F. Rau appears as payee, Robert Webb as drawer and on the reverse has endorsed the name W. F. Rau, which you admitted is your handwriting, and not that of Mr. Rau's?

A. That is right.

Q. In these five instances, you have claimed that you gave Mr. Rau the money and that is the way you did it, and yet, if you look at Exhibit 15, the ramifications of getting the cash are not resorted to at all, it is very simple, the check to cash signed by Robert Webb, drawer.

A. I couldn't possibly get the cash, either, without Mr. Rau knowing about it.

Q. Why was it not possible? Suppose you explain that. I am glad you brought it up.

Why was it impossible for him not to know about it? [219]

A. Mr. Rau knew what he had in the bank for one thing. If he saw a check for $755, do you think that he wouldn't want to know what it was for, for $3,000 or $300?

Q. Are you asking me a question, Mr. Webb? I am asking you for an answer.

(Testimony of Robert R. Webb.)

A. Well, that is my answer, that he knew exactly what was going on every minute.

Q. That is your testimony, though?

A. Yes, sir.

Q. That he knew——

A. And I think you will find the bookkeeper, she would know, too.

Mr. Gardner: If the Court please, I think the counsel for the Petitioner is now arguing with the witness.

The Witness: Mr. Rau was——

Mr. Gardner: Seeking to elicit testimony from the witness, and when the witness does testify, he says he finds fault with it, because it is testimony.

Now, I think that he should be allowed to pursue his cross-examination, but he should be cautioned to refrain from arguing with the witness.

Mr. Simpson: Almost compelled to argue with this witness, because he don't give a direct answer, and he is your witness.

The Witness: Well, I gave you direct answer that [220] Mr. Rau knew exactly what was going on with these checks, or else I couldn't have cashed a check. I don't remember the time or anything about them. I know I did cash several checks. As I explained to you this morning, on the $3500 check.

The Court: Mr. Webb, granted that Mr. Rau knew about all these checks——

The Witness: Yes, sir.

The Court: ——why did you make them out to

(Testimony of Robert R. Webb.)

cash in some instances, but make them out payable to the order of Mr. Rau in other instances.

The Witness: Well, I don't——

The Court: Is there any reason for doing it one way rather than the other way?

The Witness: No, sir.

The Court: Now, why did you make out some to cash, whereas you made out others payable to Mr. Rau, and then had to endorse his name on the back of the check before you could get the money?

The Witness: Well, I don't know. That was probably his orders, how to make it out. I don't recall that. That is eleven years ago that was, and I don't remember the occasions.

The Court: You said it was probably his orders?

The Witness: It had to be his orders; yes, [221] sir.

The Court: How often did the bank render its statement to Mr. Rau; were these monthly statements? A. Yes, sir, once a month.

The Court: And when the monthly statement came in, did the cancelled checks accompany the monthly statements?

The Witness: Yes, sir.

The Court: Who got those monthly statements and cancelled checks when they came in?

The Witness: Well, I believe they went to the bookkeeper, Miss Goldstein.

The Court: Do you know whether or not he looked, whether Mr. Rau made a practice of exam-

(Testimony of Robert R. Webb.)

ining the monthly statements, and the cancelled checks?

The Witness: I know he would make a habit of his own personal account. I don't know what he would do on these, but he would look at the check books. They were right in plain sight every day, right in the drawer, right in the front desk of the hotel. The drawer is open with the check books and the deposit books.

The Court: And these checks which comprise Exhibits 14 and 15, were drawn, were taken out of check books that were at the front desk?

The Witness: Yes, sir.

The Court: And he would examine those check books [222] every day?

The Witness: Practically every day, right there for him

The Court: Did the check stubs reflect entries that corresponded to these checks in 14 and 15?

The Witness: Yes, sir; yes, sir, and deducted every day, and every time a check was made, it was deducted right then.

The Court: He would examine these check books and stubs?

The Witness: Yes, sir.

The Court: Daily?

The Witness: I don't know whether daily or not. They are right there in front of him.

The Court: Well, would he examine them nearly every day?

The Witness: Well, he was in there all the time.

(Testimony of Robert R. Webb.)

He was downstairs in the lobby all the time. Couldn't possibly, I couldn't possibly have done it without his knowledge.

Q. (By Mr. Simpson): Where was Mr. Rau in 1947, Mr. Webb?

A. In Bakersfield most of the time.

Q. Was he living at the hotel?

A. Not in 1947. He lived out, he had a house in [223] town but he come into the hotel pretty near every day.

Q. Did he have a nurse taking care of him at that time? A. Yes.

Q. Did you know, since you knew him very well and very familiar with his physical conditions, his mental astuteness, sharpness, perhaps you can tell the Court a little more about Mr. Rau's physical condition?

That is, specifically, did Mr. Rau have control over his normal functions?

Mr. Gardner: If the Court please, I don't object to Counsel being this close to the witness, when he is showing him something or testifying from a document, but I believe——

Mr. Simpson: I will stand back.

Mr. Gardner: Thank you.

The Witness: As far as his mind was concerned, he charged us, Mr. Bender and myself, seven per cent for borrowing money from him to go into business.

Q. (By Mr. Simpson): Just a minute. I am going, asking you about his physical conditions.

(Testimony of Robert R. Webb.)

A. That is part of his physical condition, his mental condition.

Q. Talking about his physical body. [224]

A. Physical body wasn't too good in 1947, no.

Q. Who—he had a nurse who was in attendance on him? Do you know whether or not he had control over his normal functions, like his bowel movements, or his kidneys in '47?

A. I don't know for sure. I know he had a little trouble there. He had the nurse, acted as housekeeper for him.

Q. Did he not remain at that house constantly, day in and day out, after he left the hotel and came out on just rare occasions?

A. The day he was in the hotel, when the hotel was demolished in August, 1947, he was up there nearly every day in the lobby after the furniture and everything had been taken out.

Q. He was up there after it was demolished?

A. No, before the hotel was demolished, but after we closed the business.

Q. Now, it is your testimony then that Mr. Rau was up there in the hotel every day?

A. Pretty near every day, in the lobby; yes, sir.

Q. Who was with him?

A. Well, the nurse would bring him up, or his housekeeper.

Q. How did she get him into the hotel? [225]

Mr. Gardner: If the Court please, it would be much more satisfactory if Counsel would stand back.

(Testimony of Robert R. Webb.)

Mr. Simpson: I can't get a clear answer from him, frankly, when I stand back.

Mr. Gardner: I can't either, Counsel. Your Honor, I fail to hear the question, I fail to hear the answer.

Q. (By Mr. Simpson): Was Mr. Rau assisted in any way by any one in coming into the hotel in 1947? A. Yes. He would be assisted.

Q. Did he walk in?

A. Yes, he would walk in.

Q. He did not come in a wheelchair?

A. He came in in a wheelchair after we went into business, after we opened the business. I don't recall him coming in a wheelchair before that. He may have; I don't know.

I know he wasn't in very good shape, as far as his physical shape. He had bad legs.

Q. And he was in a wheelchair? In 1947?

A. The latter part of 1947, after we opened up the new French Cafe, he would come in in a wheelchair.

Mr. Simpson: Now, if Your Honor please, I am going to now offer all these on the grounds that they are [226] already in evidence conditionally, on the grounds, and for the following reasons.

Mr. Gardner: Excuse me. I didn't get the first part of that.

Mr. Simpson: I say, on these grounds, and for the following reasons.

The Court: What exhibits are you referring to?

(Testimony of Robert R. Webb.)

Mr Simpson: The Exhibits—sorry—13, 14, 15 and 16.

The Court: They are already in the record, Mr. Simpson.

Mr. Simpson: Yes, they are.

The Court: And although I may have used the word "conditionally" what I meant simply was that before I could make any use of these exhibits, or before they would be any use to the Court in any evidentiary way, they had to be tied into the case.

They are in the record.

Mr. Simpson: Your Honor, I am not quite clear, in my own mind, in view of your statement as to whether or not the Court will take, attach any weight to this evidence or not.

The Court: Well, we will give them such weight as they deserve in the light of the entire record. They are in there, in evidence. [227]

Mr. Simpson: So, the use of the word "conditionally" doesn't——

The Court: I think what I had in mind, when I used the word "conditionally" was that I would entertain a motion to strike if the Government made one at some later time, but they are in. That doesn't mean that I can give them much weight, that would depend on the entire record.

As of this moment, they seem to be rather inconclusive. But——

Mr. Simpson: Well, in the Petitioner's view, they are; of course, I have to differ with the Court. We have now been called upon——

(Testimony of Robert R. Webb.)

The Court: On brief, you can marshal the evidence and undertake to bolster the weight that you want the Court to give to them. They are in evidence, Mr. Simpson.

The Clerk: Is Petitioner's Exhibit 16 admitted?

The Court: Yes.

(The document heretofore marked for identification as Petitioner's Exhibit 16 was received in evidence.)

Mr. Simpson: There is a question in my mind as to how much further I must go in order to refute the claim that this man has made, that Mr. Rau got all the money he has testified about. We have been put to a burden here of proving defense of a dead man, that perhaps these living [228] witnesses benefitted by the thing that they have accused the dead man of, and that is what I have done here, attempted to do.

Now——

The Court: I have admitted these exhibits in evidence, and it is up to you to make your own record. If you feel you have more evidence to give, that is one matter.

Mr. Simpson: There is a question of the number of checks.

The Court: As of this, I am not talking about the number of checks, but I mean, I am thinking in terms of what effect you want me to give these very checks, themselves.

(Testimony of Robert R. Webb.)

You haven't established that this witness got these moneys for his own personal useage. There is certain amount of smoke that has been generated, but I haven't seen any fire yet. You are not going to establish any more by just bringing more checks in, unless you can bring them in with a, more light to them than you have brought in, with respect to those.

Perhaps I have, myself, apprehended some of the testimony, and if I have, then on brief, you can point out to me the power of the strength that there lies behind these checks. [229]

But I have tried to follow it attentively, the course of the trial, and simply for your own benefit, I am telling you that as of now, the matters resolving around these checks seem to me to be rather inconclusive.

Mr. Simpson: Well, in view of the fact that your Honor has been very candid, and in expressing his opinion with respect to that evidence, all I can say is that we have pursued this line in order to refute the claim for a dead person that he got the money.

Now, the evidence we have submitted, these cancelled checks through this witness, there were numerous checks that were cashed, signed by him, directly. There are other checks in which he actually forged the signature of Mr. Rau.

Now, there is only one presumption that should be made from a forged check, and that is that the forger received the benefit of the check.

Now, there is no way that we can, at this time,

(Testimony of Robert R. Webb.)

show that at the time he forged the check that he kept the money. That is not physically possible to do that at this time, to present the concrete proof, and tie the money and put it all in on Mr. Webb's person.

The Court: You are stating a conclusion, when you use the word "forge." The word "forge" to me indicates the unauthorized writing of another man's name. If this— [230] if Mr. Webb were authorized to write Mr. Rau's name, that would not be a forgery, as I understand the word forgery.

Mr. Simpson: Well, I think then before we can attach any weight to this witness' testimony, he must show that he had authority to sign Mr. Rau's name, similar to the way in which Mr. Rau does sign his name, and I haven't seen any evidence of that.

The Court: I think what we are doing is discussing the weight to be attached to the evidence. There are other factors to be taken into account. These checks had to clear. If Mr. Rau examined, in any fashion examined the bank statements, if he looked at the check books, and the stubs, he would see that checks of this sort were drawn.

I presume there is more testimony to be offered in this case, yet, that might put some light on this. This witness has testified that Mr. Rau did examine the check books from time to time. I had understood that the bookkeeper was going to be brought in as a witness.

Am I incorrect in that assumption?

(Testimony of Robert R. Webb.)

Mr. Gardner: I didn't get that, your Honor.

The Court: I said, I had understood that the bookkeeper was going to be brought in as a witness. Am I correct in that assumption?

Mr. Gardner: The Respondent intends to call the [231] bookkeeper.

The Court: I suppose inquiries could be had of her as to the extent to which Mr. Rau was familiar with the monthly bank statements, and the cancelled checks that came in.

I don't regard this matter as a closed book at this point. I say, only that up to this point I feel that the matter is inconclusive.

Mr. Simpson: Well, of course, we feel that we have a tremendous burden.

The Court: I don't want to argue with you, Mr. Simpson. If you have more evidence to present, you may present it. The evidence that you have presented thus far I have admitted, and I will consider it, and I will keep an open mind until the last item of evidence is brought into the record.

I will even try to keep my conclusions in suspense until you have had an opportunity to prepare a brief, and marshal the evidence and show me the strength that you think is in the evidence that you have assembled.

Mr. Simpson: Thank you, your Honor. I didn't mean to indulge in any argument with you, but try to show——

The Court: Proceed.

(Testimony of Robert R. Webb.)

Mr. Simpson: We do have that burden because he can really make the statement. [232]

Q. (By Mr. Simpson): Now, Mr. Webb, you have testified with respect to Exhibits 13, 14, the checks in which you got cash for Mr. Rau.

A. Yes, sir.

Q. Now, earlier you have testified that you were taking money off the top and putting it in an envelope and leaving it for Mr. Rau, and putting it in a safe place.

State why Mr. Rau would tell you, as you have testified now, go to the bank and get more cash through these checks?

A. Well, usually the money, that was the $10 a day, or $25 a day, at the end of the month would be deposited in his personal account, or he may put it in his pocket, or put it in the safety deposit box.

These checks here he wanted for some reason, cashed for some reason, which I don't know, or I don't remember, but he would have me—I couldn't possibly cash a check there and go to the bank and cash a check without him knowing it.

Q. Of course, that is a self-serving statement, Mr. Webb. Of course, now I would like to ask you this: You have this tremendous amount of cash which is being accumulated at the rate of $25 a day from the bar, $100 a day on Saturdays and Sundays, and sometimes more, $10 a [233] day from another establishment, $100 a day on Saturdays and Sundays from that one, all of which you have tucked very neatly into an envelope well labeled

(Testimony of Robert R. Webb.)

for Mr. Rau, under his daily instructions, almost over a period of six years, day by day, an act of cheating 365 times, times two for each day, times six, I believe it would amount to, and yet, with all that hoard of cash that you were accumulating, on top of that, Mr. Rau's insatiable desire for cash, according to your testimony, couldn't be satisfied until you drew cash and took that back to him, under his signature.

You were familiar with the hotel, you were the manager, you had access to the safe. There was all this hoard of cash now in the safe.

A. During that time, Mr. Rau, you know, bought a hotel in Taft. He also bought a hotel in Venice, California.

Q. Yes.

A. How he paid that I don't know, but that was some of the money that he, that was put in the safe or put in his personal account.

I don't know how it was handled, or how he handled it, because I wasn't interested in that part.

Q. Do you know whether or not Mr. Rau paid cash for the Taft Hotel that you just testified to, or did he draw a check? [234]

A. No; I don't recall how he did it.

Q. The bookkeeper would know, wouldn't she?

A. She probably would. She would have the records. I didn't have anything to do with the books. I didn't look at them. I didn't understand them.

Q. Didn't look at the books and didn't understand them?

(Testimony of Robert R. Webb.)

A. Never, no, because they didn't mean anything to me. I had no knowledge of bookkeeping.

The Court: I would like to inquire of Counsel whether Petitioner's Counsel has the check stubs from which the checks comprising Exhibits 14, 15 and 16 were taken, and, if so, it might have some——

Mr. Simpson: Yes.

The Court: ——might have, in some way throw further light upon the character of these checks that were introduced.

I am not requiring you to introduce any such check stubs, but I merely raise the question that they might throw some further light.

I am going to suspend now until Monday morning, at 10:00 o'clock.

(Whereupon, at 3:05 p.m. the hearing in the above-entitled case was recessed until 10:00 o'clock a.m., Monday, June 30, 1958.) [235]

Mr. Simpson: If your Honor please, at this time I would like to file Petitioner's trial memorandum, which was prepared over the week end.

The Court: It will be received. Always glad to get a trial memorandum.

Mr. Simpson: I believe Mr. Webb was on the stand when we finished last Friday.

ROBERT R. WEBB

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Cross-Examination

(Continued)

By Mr. Simpson:

Q. Mr. Webb, when we finished last Friday, we were discussing checks drawn by you to cash as I recall, and I believe your testimony is that Mr. Rau was acquainted with the transactions, because every day he came down to the desk and looked at the cancelled checks, or the check stub book; is that correct, sir?

A. Practically every day.

Q. Practically every day? A. Yes, sir.

Mr. Simpson: Would you mark this Petitioner's Exhibit next in order for identification; I think it is 17?

The Clerk: 17 is correct. Petitioner's Exhibit No. 17 marked for identification. [238]

(The document above referred to was marked Petitioner's Exhibit No. 17 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit 17 for identification, and direct your attention to check stub marked No. 751, and ask you to review that check stub in connection with the cancelled check, itself, No. 751, which is part of Petitioner's Exhibit 15. A. Yes, sir.

Q. And ask what did Mr. Rau learn when he looked at the check stub on check No. 751?

(Testimony of Robert R. Webb.)

A. Mr. Rau would come down and have me write out a check. He may have had me write it out, take it out of this book account, and put it in another account, if he saw that—when the account had too much money in it, he would maybe transfer it into the French Cafe account, or Southern Hotel account, or have me cash the check, bring the money to him, or put the cash, put the check into his private account, in his own private account under W. F. Rau.

Q. Now, I will repeat the question.

When Mr. Rau saw the check stub book on check No. 751, in order to keep himself familiar, as you said, with all of his banking transactions—— [239]

A. Yes, sir.

Q. ——what did Mr. Rau learn by looking at that check stub?

A. He understood exactly what the check was for.

Q. He understood what it was for?

A. Yes, sir.

Q. Explain that, what did he learn when he looked at the check stub?

A. He would be right there when I wrote the check. Otherwise, I wouldn't have written the check on his name. I would take it to the bank. I may have gotten cash. I may have transferred this into his private account, which would show on his—if you have his account book, or he may have had me bring the cash back and put it in the safe.

Q. Mr. Webb, you haven't answered my ques-

(Testimony of Robert R. Webb.)

tion, but now that you have mentioned it, did Mr. Rau observe you draw every check that you drew?

A. Any check that I drew under his, for cash or for anything like that, he would be right there, when I cashed it, when I drew them; yes, sir.

Q. He was right there at the desk when you drew the check to cash?

A. He must have been, or else he told me to cash it upstairs, or I don't know, but chances are he was right [240] there when I cashed it, otherwise, I couldn't have made the check out.

The Court: What did the particular check stub here say, just read it.

The Witness: It says, cash, W. F. Rau.

The Court: And the amount?

The Witness: $755.

The Court: Is that the same amount that appears on the check?

The Witness: Same amount; yes, sir.

Q. (By Mr. Simpson): When Mr. Rau saw this, what did he learn from the fact that there was a check with W. F. Rau for $755; what did that tell Mr. Rau?

A. Well, I don't know what it would tell him, but he would be right there when I would make the check out, or instruct me to make the check out.

The Court: Well, the check, may I see that check stub? The check stub seems to read to cash, and then next to the word for, f-o-r, appears W. F. Rau.

What does that mean, does that mean that the

(Testimony of Robert R. Webb.)

cash was $755 was taken out for Mr. Rau; is that what that means?

The Witness: Yes, sir, your Honor. Mr. Rau would have a large balance. He had $10,000 here, so he [241] would probably come down and say, "let's cut that down, too much money to keep in there. Put it in another account," or transfer it to make the check into his own personal account.

The Court: That is $755, is a rather odd number.

The Witness: Well, he was an odd man. He would do things that way.

Q. (By Mr. Simpson): You mean he was peculiar? A. No; he wasn't peculiar, sir.

Q. He was odd?

A. Well, thinks like this, yes. He would—I don't know just what his reasons were.

Q. Was it necessary for him to come downstairs and tell you to draw a check on Southern Wine and Liquor Company, when you already had the authority to do that?

A. I could have written the checks out for the $10,000, I suppose, but he would have known it, naturally, the same day I had that authority.

Q. You already had the authority, did you not, Mr. Webb? A. Yes, sir.

Q. To draw the checks?

A. That is right. My name is on all these checks, sir. [242]

Q. Now, please explain, if you will, why it was necessary for you to have Mr. Rau come downstairs and tell you to draw a check for $755 on January

(Testimony of Robert R. Webb.)

4, 1945, when you already had the authority to do so?

A. Well, naturally, I wouldn't draw a check on his account unless I had authority from him.

Q. In other words, every time you drew a check you obtained his permission first?

A. Absolutely.

Q. Absolutely. There is never any exception to that now, Mr. Webb?

A. No; there is exceptions.

Q. All right. Now, what are they?

A. I cashed—any supplies come in, I would naturally, I wouldn't have to ask his permission. I would cash it. I would make the check out for the amount of the bill.

Q. Supplies for what?

A. Well, bar supplies, all bar supplies were paid by check. I didn't ask his permission for that. I drew a voucher for everything to show for any check I drew. There was a voucher for it, for any supplies.

Q. From whom did you get the voucher?

A. From the delivery man.

Q. Why were you in the bar? [243]

A. Part of the time, if I wasn't in the bar, it would be brought to me at the hotel lobby.

Mr. Simpson: At this time, your Honor, I offer into evidence Petitioner's Exhibit 17 for identification, check stubs just referred to by this witness.

Mr. Gardner: No objection, your Honor.

The Court: Admitted.

(Testimony of Robert R. Webb.)

(The document heretofore marked Petitioner's Exhibit No. 17 was received in evidence.)

Mr. Gardner: Does that exhibit, as I understand it, your Honor, relate only to this check stub? I believe that is what Counsel stated.

Mr. Simpson: No. It relates to other checks and check stubs, as well.

Mr. Gardner: This relates to check stubs from October 26, 1944, to January 30, 1945; is that correct?

Mr. Simpson: Well, let's—better identify it. Your suggestion is good.

Check No. 601, check stub No. 601, rather, through 800, inclusive.

The Court: Are you offering the entire exhibit now?

Mr. Simpson: The entire exhibit, yes.

The Court: It will be received. [244]

Mr. Simpson: Please mark this as Petitioner's Exhibit, for identification, 18.

The Clerk: Petitioner's Exhibit No. 18 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 18 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit 17 for identification—18 is it? Just a minute.

The Clerk: 18.

Mr. Simpson: 18, I am sorry.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): And in connection with that, I show you check No. 1146, which is part of Petitioner's Exhibit 15, and ask you to look at check stub No. 1146, which corresponds with that check.

A. Yes, sir.

Q. And ask you what Mr. Rau would learn when he came downstairs and looked at the check stub on check No. 1146?

A. Mr. Rau would be right there when I would write the check.

Q. What did he learn when he saw this?

The Court: What did the check stub say?

The Witness: The check stub says cash, [245] your Honor.

The Court: And how much?

The Witness: $615.

The Court: Is that the same amount that appears on the corresponding check in Exhibit 15?

The Witness: Yes, your Honor.

Q. (By Mr. Simpson): Did Mr. Rau understand that that check to cash was to be given to him? A. Absolutely; yes, sir.

Q. And not to deposit?

A. It could have been deposited; it could have been cashed. It could have been transferred to his own account. It could have been put in another account. It could have been put into the French Cafe or Southern Hotel account.

Q. In other words, would you know what happened to the money, if you looked at the check, itself, the cancelled check No. 1146?

(Testimony of Robert R. Webb.)

A. That is 1944 and I can't remember back that far, because I cashed a lot of them. I don't remember the occasion or anything about it.

Q. Well, then, your testimony is that you cannot determine?

A. It could have been, it could have been transferred to one of his other accounts. It could have been [246] put in his own account. It could have been cashed which he would have, which I would give to him, same day.

Q. Now, Mr. Webb, if it were the latter, would you please explain the purpose of having you draw a check to cash when he was taking off $25 a day, and $100 on Saturdays, $100 on Sundays, $10 a day from another business, $100 on Saturday, $100 on Sunday; would you please explain to the Court, if you will, why it was necessary for Mr. Rau to draw a check to cash, which you drew in your name?

A. It could have been put into one of the other accounts he had. The balance here was $2,759.79, which he probably figured was too much money to carry in that account, so he probably transferred it to one of his other accounts.

The Court: $2,000 or $20,000?

The Witness: $20,000; yes, $20,759.79.

Q. (By Mr. Simpson): And he probably figured that that was too much money?

A. I don't know what he thought, sir. I haven't any idea what he would—thinking that would probably be the reason.

(Testimony of Robert R. Webb.)

Q. Well, when he asked you to draw the check, didn't he tell you why? [247]

A. No doubt he did. I can't remember every occasion that happened 15 years ago, or more.

Q. Well, now, I want to get from you, if I can, the explanation.

A. I certainly wouldn't write a check unless I was given a check.

Q. You were withholding the money which you testified day after day, Saturdays and Sundays, it was $100 and sometimes even more, that you put that cash in an envelope and put it in the safe?

A. Yes, sir.

Q. Now, that cash was accumulated at a very rapid rate then; I ask you what would be your explanation for going to the bank and drawing a check for $615 to cash, signed by you, with all the cash that you had in the safe?

A. You might look in his other accounts, on the French Cafe, or the Southern Hotel. You might find a check for $615 deposited in that other account.

Q. Now, suppose you do not find it, what would be the explanation, Mr. Webb?

A. Well, he got the cash, then the only other thing I could think of, he kept a lot of money in the safe, sometimes.

Q. Didn't you know that all that money was in the safe? [248]

A. Sometimes he would give me, maybe, $2,000 to go up and get one thousand dollars bills.

Q. I want you to answer this question, Mr.

(Testimony of Robert R. Webb.)

Webb, sir, with the money that was in the safe, and you knew that was in the safe, day after day you put it in there, in the envelopes——

A. That is correct.

Q. Then, why was it necessary to draw a check for $615 on the 4th day of January, 1945, by you to cash, with the cash that was in the safe?

A. I don't remember. That is 13 years ago. I can't remember just what happened.

The Court: How long did the cash remain in the safe, there—I am speaking of the cash that was taken off the top, as you have described it?

The Witness: Well——

The Court: Did he remove—I seem to recall that you said last week that it was removed once a month?

The Witness: Usually once a month, sir.

The Court: Well, when?

The Witness: Well, probably the first of the month, first of every month, second of the month, whatever it is, you know. He might take some of that money out, and go up and get his thousand dollar bills with it, and say, take so much more and get me a thousand dollar bill, the [249] bank has one or two thousand.

The Court: From the safe?

The Witness: Yes, sir.

The Court: Well, when would it—but was it usually his practice to remove the money from the safe each, at the beginning of each month?

The Witness: Yes, sir, your Honor.

(Testimony of Robert R. Webb.)

The Court: Would that leave the safe bare then?

The Witness: No. He usually had some of his own account there.

Mr. Simpson: Just a minute, I would like to have that answer.

The Court: Will you develop that, Counsel?

Mr. Simpson: I would like to have that answer definitely stated for the record.

The Witness: Well, we always——

Q. (By Mr. Simpson): Just a minute. Was the cash depleted on the first of the month by taking it out of the safe?

A. We usually had a bank. I forget how much it was, in the safe.

Q. Don't go any further. Approximately how much was in the safe?

A. I don't remember. [250]

Q. Just give a guess.

A. I wouldn't even give a guess. It is too long ago. We handled a lot of money around there, but I don't remember.

Q. Well——

If your Honor please, if this witness can't remember, then I can't develop his testimony.

A. It is a long time ago.

Q. What do you remember about the transaction then?

A. Just as I said, it was usually, we always had an extra bank to cash checks, other such things. Might have been a thousand dollars bank there probably around five hundred or a thousand dollars. I am not sure.

(Testimony of Robert R. Webb.)

The Court: Was that money over and above the amounts that were taken off the top from the French Cafe and the bar?

The Witness: Well, that would be a special bank for cashing, maybe, pay checks, or maybe similar things like that.

Q. (By Mr. Simpson): Well, it is true, is it not, Mr. Webb, that you kept a great deal of cash, as a matter of fact, in that safe for that very purpose of cashing checks?

A. Might have been as much as a thousand dollars, five hundred or maybe more than that, but I don't recall. [251] I don't remember.

Q. But you did keep a substantial amount in there for the purpose of cashing customer's checks, did you not?

A. Well, maybe for other reasons. I don't know.

Q. Well, now——

A. He might have kept some money in an envelope for himself.

Q. If you were shown deposits going into the bank accounts, in the form of checks, would your explanation be then that you kept the money in the safe for the purpose of cashing checks?

A. Well, we cashed quite a few checks around there, but I don't remember just how much money he had in there. He may have had some of his own money in an envelope.

The Court: But if you did keep money in the safe for the purpose of cashing checks, I would presume that sooner or later that would be depleted

(Testimony of Robert R. Webb.)

by paying it out for checks and it would have to be replenished from time to time?

The Witness: Yes, sir.

The Court: Now, how was it replenished?

The Witness: Well, I would cash the checks and put the money back in the envelope or put them back in the safe. [252]

Q. (By Mr. Simpson): What were you doing with the money that you were taking off the top, as you said, then?

A. I thought I explained that. It would be $300 or $310 or $750 or $775, Mr. Rau would get that the first of the month. He might have me get large bills from the bank; he might put it in his own account.

Q. You keep talking about Mr. Rau getting large bills. Now, if Mr. Rau had that money there, Mr. Webb, for the purpose of cashing checks, why would he want these large bills, now?

A. Well, Mr. Rau had—I am getting back to that $1,000 again—he kept some of them in the safe, because he didn't go to the bank every day, naturally.

Q. He didn't go at all, did he?

A. He didn't go to the safe deposit box every day.

Q. He didn't go to the bank at all?

A. Yes; he did go. I told you he went to the safe deposit box at Anglo Bank.

Q. Well, Mr. Webb, without going into that, the record will show.

(Testimony of Robert R. Webb.)

Mr. Gardner: If the Court please——

Mr. Simpson: I am not asking that question. It is not responsive to my question, Mr. Gardner.

Mr. Gardner: Might Counsel for Petitioner be instructed to let the witness answer and not interrupt him? [253]

Mr. Simpson: It is all right if he is responsive, but I didn't ask him anything about the safe deposit box, Mr. Gardner.

Mr. Gardner: There have been several times this morning that the witness has been trying to answer, and he has been interrupted.

The Court: I instruct Counsel to let the witness complete his statement before putting another question to him.

The Witness: I understood you to say that Mr. Rau never went to the bank. All I was trying to say is that he went to the, did go to the Anglo Bank occasionally. He may have gone to the Bank of America, but very rarely. I don't remember him going up there. We probably had, but I don't remember any occasion.

But I did go to the Anglo Bank with him more than once.

The Court: And the Anglo Bank was the bank in which he kept his safe deposit box?

The Witness: Yes, sir, your Honor.

The Court: When he went to the Anglo Bank, his purpose was what; was it to go to the box or was it to conduct other business transactions at the bank?

(Testimony of Robert R. Webb.)

The Witness: To go to the box, sir. [254]

Q. (By Mr. Simpson): As to the check to cash, drawn by you for $615, I ask you once again, the purpose of drawing the check in that amount of money, when there was substantial cash in the safe which you had put there, yourself?

A. I drew the check under Mr. Rau's instructions. That is the only thing I could tell you on it.

He had $20,000, over $20,000 in there, and he probably said, "Well, let's cut that down a little bit," which he would say more than once on his different accounts.

Q. Well, then, so that there is no mistake, please, I am not going to interrupt you, your explanation is that he had more money in the bank than he wanted?

A. I don't believe I said that, more money.

Q. Would you please tell me why?

A. In that account, more money in that account.

Mr. Gardner: Once again, we are having bickering and argument with the witness. We can't get his answers.

Mr. Simpson: I sure can't.

Mr. Gardner: If Counsel asks the witness a question, he should allow the witness a chance to answer.

The Court: Proceed.

The Witness: Well, he had $20,000 in here; he may have said we will take off a little bit and put it in another account. [255]

And if you have the other account books, or other

(Testimony of Robert R. Webb.)

check books, you will probably see this $615 deposit. There were occasions when he would maybe be short on an account, or overdrawn, almost, and he would take some money out of one account and put it in another.

Q. (By Mr. Simpson): Mr. Webb, you have an account of your own at the Bank of America, do you not? A. Yes; I have.

Q. You have drawn checks to cash on your own bank account, have you not? A. Yes.

Q. I ask you whether or not you ever observed on your own checks a stamp No. 111? 111 stamp as it is known. A. Bank of America, yes, sir.

Q. Can you testify and do you know the significance of that 111?

A. No; I don't. I don't know anything about the 111.

Q. If this check, Mr. Webb, had been deposited in the bank account, would not the stamp reflect that on the reverse side, or do you know?

A. I don't know. He probably got cash for it, if it wasn't deposited in another account. [256]

Mr. Simpson: At this time, your Honor, I wish to introduce in evidence Petitioner's Exhibit 18, just referred to by this witness, being the check stub from 1001 to 1200.

Mr. Gardner: Well, if the Court please, the last exhibit that went in for the Petitioner related, of course, to checks previously in, but at this time, I would like to once again object to the introduction of this testimony, and the introduction of these

(Testimony of Robert R. Webb.)

exhibits, because I don't see their materiality at all.

I don't think there has been any foundation laid for the introduction of this evidence.

The Court: Does 18 contain the check stub that pertains to that $615 check in Exhibit 15?

Mr. Simpson: Yes; it does. It is the same.

The Court: I will receive it.

(The document heretofore marked as Petitioner's Exhibit No. 18 for identification was received in evidence.)

Mr. Simpson: Would you mark this as Petitioner's Exhibit, for identification, next in order?

The Clerk: Petitioner's Exhibit No. 19 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 19 for [257] identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit for identification, No. 19, being the check stub book of the Southern Wine and Liquor Company, and ask you to look at check stub No. 753, in relation to the same, the cancelled check, itself, No. 753, being part of Petitioner's Exhibit 14.

And ask you to look at the check stub, and tell what Mr. Rau learned when he saw that check stub?

A. Mr. Rau was right there when I wrote the check, had to be.

(Testimony of Robert R. Webb.)

Q. He had to be there when you wrote that check?

A. Yes, sir. I wouldn't have written it unless he was there.

The Court: The witness' answer is not responsive.

Mr. Gardner: May I object further to Counsel's question? He is asking him what Mr. Rau learned.

Now, this witness can't tell what Mr. Rau learned. He can state what is on that check stub, but it is beyond his knowledge as to what Mr. Rau learned.

Mr. Simpson: If your Honor please——

Mr. Gardner: I think he should rephrase his question.

Mr. Simpson: If your Honor, please, the [258] purpose of asking him the question was that the other day Mr. Webb stated that Mr. Rau learned all about these bank accounts by looking at the check stubs.

I think, if the Reporter would go back and read that, you would find that that is what he said.

The Court: My interpretation of his testimony of the other day was something along these lines, namely, that when he drew these checks—that is when this witness drew these checks—he wasn't doing anything in secret, that he was drawing a check, either to cash or to Mr. Rau's name, and that Mr. Rau simply by looking at the check stubs could see that such a check had been drawn.

And the inference obviously would be that it would have been impossible in those circumstances

(Testimony of Robert R. Webb.)

for this witness to have pocketed the proceeds of those checks, because Mr. Rau would have seen right on the check stub that a check had been drawn in that amount, and with such and such a payee.

So that if there had been anything potentially improper about it, Mr. Rau would have been able, at once, to correct this witness and ask him what had been done with the proceeds.

Now, that was my interpretation of his testimony of last Friday.

Mr. Gardner: Yes, I think that is right. [259]

The Court: And thus far, the check stubs that have been introduced appear to bear out the witness' prior testimony, because the check stubs appear to accord with what appears on the face of the checks, themselves.

Mr. Simpson: That is true; that is correct.

The Court: Proceed, Mr. Simpson.

Q. (By Mr. Simpson): Now, as to check stub 806——

The Court: That is in exhibit——

Mr. Simpson: 19.

The Court: 19.

Q. (By Mr. Simpson): I ask you to refer to that check stub in connection with the cancelled check, itself, 806, which is part of Petitioner's Exhibit 14, and you will see that the check stub is for $1,000? A. Yes, sir.

Q. Corresponds with the check, itself. The check, itself, is drawn——

(Testimony of Robert R. Webb.)

The Court: Is the payee the same on the check stub as appears on the check, itself?

Mr. Simpson: It is. Presumably it is, it is W. F. Rau on the check stub, the payee on the check is W. F. Rau. [260]

Q. (By Mr. Simpson): The check was drawn by you, Mr. Webb? A. That is correct.

Q. Robert Webb? A. That is correct.

Q. When Mr. Rau saw this stub, he knew that a check had been drawn to him?

A. Yes, sir, absolutely.

Q. And the check stub was written at the same time that the check, itself, was written; is that correct? A. Must have been.

Q. And Mr. Rau was present when the check was written? A. Yes, sir.

Q. And that was down at the desk?

A. It would have to be. I wouldn't cash the check unless he was there.

Q. He had to be there.

Now, I direct your attention to check stub No. 917, included in Petitioner's 19 for identification, and ask you to look at that in connection with the cancelled check No. 917, on the Southern Wine and Liquor Company in the amount of $3,500.

A. That is the same.

Q. Is it the same? A. Yes, sir.

Q. The cancelled check, itself, in other words, and [261] the amount of the check stub and the payee are identical? A. Yes, sir.

Q. The same check being drawn by you?

(Testimony of Robert R. Webb.)

A. Yes, sir.

Q. To W. F. Rau? A. Yes, sir.

Q. And he was present downstairs at the time you drew that check? A. Must have been.

Q. Looking at check No. 753, part of Petitioner's Exhibit 14, looking at the endorsement thereon—— A. Yes, sir.

Q. ——is that Mr. Rau's?

A. That is my writing.

Q. That writing, read that writing. What does it say? A. W. F. Rau, R-a-u.

Q. That is your writing? A. Yes.

Q. Check No. 806, I ask you to look at the endorsement thereon. A. That is my writing.

Q. What does it say?

A. W. F. Rau, Sr.

Q. What is endorsed?

A. W. F. Rau, Sr. [262]

Q. I ask you to look at check No. 917, and look at the endorsement thereon. A. W. F. Rau.

Q. And ask who wrote the signature?

A. That is my writing.

Q. Now, in this connection, Mr. Webb, I call your attention to check No. 10, French Cafe, part of Petitioner's Exhibit 14, and ask you to look at the endorsement thereon, and read what it says into the record. A. W. F. Rau.

Q. And did Mr. Rau write that?

A. No; I wrote it.

Q. You wrote it? A. I wrote all those.

Q. Check number 319, drawn on the French

(Testimony of Robert R. Webb.)

Cafe, part of Petitioner's Exhibit 14, looking at the reverse side thereof, the endorsement, would you state whether or not that is Mr. Rau's signature, or you wrote his name?

A. I wrote his name.

Q. Now, Mr. Rau, you correct me if I am wrong, was present at the time you wrote these checks that we have been talking about here, this morning?

A. Excuse me, sir. That looks like his signature there, doesn't it? Looks like Mr. Rau's signature.

Q. Well, Mr. Webb, I haven't asked that. [263] That will be developed later.

You were instructed and Mr. Rau was present when you drew these checks that we have been talking about here, contained in Petitioner's Exhibits 14 and 15, and he knew at the time that the check was written that you wrote the check?

A. He knew I wrote the check. He had to know it.

Q. He had to know it?

A. He would have to know that he instructed me to write the check. It is possible that he may have called me up from down some other place, and have me write a check and put it in the bank. I couldn't swear to that.

Q. Now, when the endorsement was put on the reverse of this check, where was Mr. Rau then?

A. I don't know where he was, probably right down there. Maybe I wrote it in the bank, right at the teller's cage. I am not sure.

Q. And before you left Mr. Rau, he was stand-

(Testimony of Robert R. Webb.)

ing at your side when you wrote the check, he said to you, "Mr. Webb, endorse my name on that check"?

A. No, but he knew that I endorsed it. He would know if there was any question, he knew that all he wanted to get, was to get the money or have it transferred. There was no secret about my putting his name on there, with him. [264]

Q. He knew that you had put his name as an endorser?

A. Otherwise, he would have written out the whole check, himself. That is the reason he had me sign for all these checks, so he wouldn't have to be bothered with doing any of this writing, because he was a little bit nervous.

Q. My question is, did Mr. Rau, at the time that he instructed and knew that you wrote check No. 753, on the Southern Wine and Liquor Company, the Bank of America, check No. 806, on the same company, and the same bank, check No. 917 on the same company and the same bank, check No. 10 on the French Cafe, and the Anglo California National Bank, check No. 319 on the French Cafe, the Anglo California National Bank; at the time Mr. Rau instructed you to draw those checks that he also instructed you to endorse his signature on the reverse of the check, did he tell you to do that?

A. I don't remember; probably not. Probably didn't tell me anything. He wouldn't tell me anything on it.

Q. Will you please explain?

(Testimony of Robert R. Webb.)

A. The only thing I would be given orders to, would be to get money from the bank, or deposit it in the bank. It would be impossible for me to get it any other way.

Q. You through, Mr. Webb?

A. I am through, sir.

Q. Please explain then why you wrote Mr. [265] Rau's signature as an endorsement on those checks, which I have just read off to you?

A. I could have written the check for cash and as far as that part goes, I don't know the reason. I could have written it off for cash, instead of putting his name on there.

Q. That answer is not responsive.

A. I don't understand just exactly what you mean then.

Q. Why did you put Mr. Rau's signature on the reverse of the check in the form of an endorsement thereon?

A. Because I had already put his name on the face of the check. I wrote his name on the face of the check to get the money, or to transfer it to another account. I had to endorse it in the back, but there is nothing secretive about it.

Q. Mr. Webb, did you have the authority to draw on the Southern Wine and Liquor Company account in the Bank of America?

A. Yes, sir.

Q. Then, could you not have drawn that check to cash or to yourself, even in that amount of money, without Mr. Rau ever being consulted?

(Testimony of Robert R. Webb.)

A. It would be impossible for me to cash a check——

Q. Answer yes or no. A. No. [266]

Q. You could not? A. No, sir.

Mr. Simpson: At this time, your Honor, I offer into evidence Petitioner's Exhibit 19, being the check stub book on the Southern Wine and Liquor Company, starting with 701 through 1,000 and beginning with the date of March 5, 1947, and ending July 24, 1947, Petitioner's Exhibit 19, just referred to by this witness.

Mr. Gardner: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification Petitioner's Exhibit 19 was received in evidence.)

Mr. Gardner: I would like also to have the witness continue with his explanation that he was cut off from, Counsel, as to his last answer.

The Court: Had you completed your answer, Mr. Webb?

The Witness: About Mr. Rau knowing exactly what I did; yes, sir.

Mr. Simpson: I did not ask that question; I asked for a yes or no answer to a question.

Q. (By Mr. Simpson): Mr. Webb——

If your Honor please, I believe that as the [267] record now stands, with respect to the duties of this witness, and I realize and appreciate the fact that that's been covered once, but I do not think that

(Testimony of Robert R. Webb.)

is going to be as clear as it might be, and for that reason, I would like to go back with this witness now and get specific functions he performed as manager, when he was manager, and what he did as clerk, when he was clerk.

The Court: There will be a short recess.

(Short recess.)

Q. (By Mr. Simpson): Mr. Webb, I wish you would take your time, be very specific.

A. Yes, sir.

Q. In answering these questions?

A. Yes, sir.

Q. What was the date you began your employment with Mr. Rau?

A. I don't know the date. I think it was 1932.

Q. What were your duties at the time you became his employee in 1932? A. As a clerk.

Q. As a clerk? A. Yes, sir.

Q. Well, what did you do as clerk?

A. Well, my duties as a clerk were to register people [268] in and——

Q. Was that only in connection with the Southern Hotel?

A. Yes, sir. At that time, that is the only place we had.

Q. Did you do anything else as clerk at the Southern Hotel?

A. At first, that is all I did, was as clerk. My first work for him.

Q. That would be room clerk?

(Testimony of Robert R. Webb.)

A. A room clerk; yes, sir.

Q. And for how long a period of time did you work as a clerk in the Southern Hotel?

A. Might have been a year, two years; I don't know.

Q. A year or two years? A. Yes, sir.

Q. After 1934, did your duties change?

A. After 1934, I believe the Halsted Act was repealed and Mr. Rau opened up a bar, also a restaurant.

Q. He opened both in 1934? A. Yes, sir.

Q. As clerk, did you do anything, or were you called upon to do anything with respect to the bar and restaurant in 1934?

A. 1934, when the bar opened, I took the [269] cash, received the cash from the bar, also from the French Cafe.

Q. You received the cash from whom in the bar and cafe?

A. The cafe, it was brought to me each morning by the steward or whoever was in charge of the restaurant.

Q. From the bar?

A. From the bar, I would go in at four o'clock in the afternoon, and get the receipts, put them in an envelope, put it in the safe.

Q. From whom did you receive the cash?

A. I received it from the cash register. I took the cash out, myself.

No. 16823

United States
Court of Appeals
for the Ninth Circuit

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Petitioner,

vs.

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(Testimony of Robert R. Webb.)

Q. Did you cease your functions as clerk of the hotel after 1934, when the bar and cafe were opened by Mr. Rau?

A. Some time around, about that time, he said, put me in charge.

Q. In charge as what?

A. Well, he gave me—of the hotel, and Southern Wine and Liquor Company, the Southern Bar, not to do any hiring in the bar. I had nothing to do with the hiring of bartenders or any of the other help in there. Or I had nothing to do with hiring the help in the French Cafe.

Q. Well, what was the title of your position after 1934? [270]

A. Well, Mr. Rau gave me a title as manager.

Q. As manager. You got the receipts from the cafe after 1934, from the steward?

A. The steward or whoever was in charge in there, the cashier.

Q. Thank you. After 1934, you took the cash from the bar out of the cash register?

A. That is correct.

Q. Now, for how many years subsequent to 1934 did you continue to do those things, those two things that we just talked about?

A. Up until the hotel was demolished.

Q. Do you recall the date on which the hotel was demolished?

A. It was on August, '47, I think it was around the 6th, 7th or 8th.

Q. This that you have just explained, you did

(Testimony of Robert R. Webb.)

consistently from 1934 up until the date that the hotel was demolished some time in August of 1947?

A. Every day that I was there at the hotel; yes, sir.

Q. Was there anything else in addition to this that you did?

A. Well, I took charge of the bellboys, the other clerk.

Q. Now, just a minute. Took charge of the bellboys [271] and clerk, explain what you mean by "took charge of"?

A. Well, I would hire them and I would have the privilege of firing or hiring them.

Q. Did you hire or fire any other employee of the hotel?

A. Maybe a maid or maids, something like that, I might have.

Q. Maybe a maid?

A. Well, we had several maids. Might have had authority to hire any of them.

Q. While you were acting as manager, did you have anything to do with the receipts of the hotel?

A. Yes; I did.

Q. What did you have to do with the receipts of the hotel?

A. I would take the receipts, the same as I did the other accounts.

Q. Now, you worked from 7:00 o'clock in the morning until 7:00 o'clock in the evening; is that correct?

(Testimony of Robert R. Webb.)

A. For a period of time, I would take two hours off at noon, probably from 12:00 to 2:00.

Q. For a period of time?

A. Two hours—excuse me.

Q. After 1934, please state the number of hours you worked each day. [272]

A. Well, actually, I worked ten hours a day, up until maybe 1944 or '45.

Q. Now, there was a change then, was there not, after 1945?

A. About 1944 or 1945, I was carried to the hospital on a stretcher, and I was out probably a week or ten days.

Q. In what month?

A. I don't recall the month, but during that time, I was out.

Q. Wait a minute. Before you answer that, you were out for a week or ten days in some time in 1945?

A. '44 or '45, I don't recall the year.

Q. You were taken out on a stretcher and taken where? A. To the Mercy Hospital.

Q. The emergency hospital?

A. Mercy Hospital.

Q. Mercy? A. Yes, sir.

Q. During that week or ten days, do you know who performed your duties?

A. I understand Miss Goldstein.

Q. You are unable now to recall whether it was 1944 or 1945? A. I don't remember. [273]

(Testimony of Robert R. Webb.)

Q. Would you care to state the nature of your illness?

A. Well, that morning I went to the bank and I couldn't pick up a pencil, so I sat down awhile, and rested. I thought I would be all right, and I went to the bank as usual.

I came back and I felt very weak, sat down in a chair, and I believe Miss Goldstein noticed. Some guests came up to the counter, and I couldn't get up.

So they took me to my room and called a doctor. And the doctor ordered me in the hospital.

Q. And you never learned the nature of your illness?

A. Well, I think it was a slight stroke on my right side, was——

Q. Was that because of overwork, did the doctor say?

A. Well, I don't remember the doctor saying anything about it.

Q. Did they recommend anything for you?

A. Shortly before that, I think it was the time when they had these new wonder drugs, and I had a cold, and Mr. Rau said take some of these pills, take one, maybe every hour. So I took them home and I took them every hour. And he called me up at my home, and he said, "Don't take any more of those pills. I told you wrong," he says that should be every four hours. Whether that had [274] anything to do with it, I don't know.

(Testimony of Robert R. Webb.)

Q. Well, did you ask the doctors if that had anything to do with it?

A. I don't remember. I was in pretty bad shape there for a couple days, and I don't recall what went on with the doctors.

Q. Did you explain that to the doctors at that time? A. I probably did.

Q. What was their answer?

A. I don't remember.

Q. You don't remember? A. No.

Q. Were there any other duties as manager of Southern Hotel over and above that which you did for the bar, and the taking the cash from the steward at the cafe?

A. Well, just to see that it was order kept in the hotel, and the hotel was kept clean and check on the maids, and the other clerks. That is about all.

Q. How many hours a day did you devote to the management of the hotel?

A. Well, it was ten hours a day, from up until 1944 or '45, and after that, I would go in and work around 9:00 o'clock, 10:00 o'clock in the morning, and probably stay until 5:00 in the afternoon. Maybe 5:30, 6:00, no special time. [275]

Q. So, you worked ten hours a day at the hotel?

A. Practically ten hours; yes, sir.

Q. How much time did you devote to the bar, and the cafe?

A. Well, very little time to the cafe. In fact, I didn't have anything to do with the cafe. The bar,

(Testimony of Robert R. Webb.)

I would go back and forth, but no special hours or anything like that.

Q. Nothing to do with the cafe?

The Court: You mean apart from receiving the cash?

The Witness: Yes, sir, your Honor.

Q. (By Mr. Simpson): During the time that you were obtaining or receiving the receipts from the cafe, you received daily receipts from the steward, did you? A. Yes, sir.

Q. And also the cash, at the same time?

A. Yes, sir.

Q. When you received the daily sheets from the cafe, you took a deduction from those receipts, did you note the amount of the deduction on the day which you received that daily sheet from the steward of the cafe?

A. Well, $10 a day every day in the week.

Q. Wait a minute, now. I don't want to interrupt you. At the time you received the daily sheets from the [276] steward of the cafe, along with the cash, did you or did you not on that same day write down on the sheet the amount taken off?

A. Well, I wrote down the amount taken off. I might have—take it off of the total receipts, but I would take off $10 anyway, every day.

Q. Are you through, sir; is that your answer?

A. Yes, sir.

Q. I ask you, at the time you received the daily sheet from the steward at the French Cafe, along with the cash, did you, or did you not, on that same

(Testimony of Robert R. Webb.)

day, write down on the daily sheet the amount of money taken off the top, as you say?

A. I would take off $10 a day. Might have been occasions where Mr. Rau would say take the $10 off the total receipts.

Q. Mr. Webb, I know that I don't want to interrupt you. I have asked that same question twice. You have yet to answer it. A. Yes. Then——

Q. The answer is yes, you put it, wrote it down on the same day that you received the daily sheet from the [277] steward?

A. Same day; yes, sir.

Q. All right. Sir, did you write anything else down on those daily sheets at that same time, other than the amount taken off?

A. I would probably deduct the supplies from the total.

Q. You say deduct the supplies from the total. Did I understand that answer correctly?

A. Yes, sir.

Q. Did you write anything else?

A. I don't remember that I wrote on them now, unless I could see the sheet.

Q. I will ask you, did you add anything?

A. At times, I would. Mr. Rau would have me add a check to it, to make it respectable, what he thought would be a respectable figure.

In other words, after we get through deducting, we had $250, he might have me write out a $50 check to make it over $300.

(Testimony of Robert R. Webb.)

Mr. Simpson: Would you mark this group of papers Petitioner's Exhibit next in order.

The Clerk: Petitioner's Exhibit No. 20 marked for identification. [278]

(The documents above referred to were marked Petitioner's Exhibit No. 20 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I show you Petitioner's Exhibit—just a minute, sorry. Strike that from the record.

Mr. Webb, I show you Petitioner's Exhibit 20 for identification, and ask you if you can identify No. 10 appearing under $283.60?

The Court: Showing him the front sheet for that exhibit.

Mr. Simpson: Yes.

Q. (By Mr. Simpson): Bearing date of September 20, 1943, and ask if that $10 underneath that figure, below that figure, is written by you?

A. It was.

Q. The balance then becomes $273.86; is that correct? A. Yes, sir; that is correct.

Q. Now, there is the sum of $33.35, which is added to that result, making the total of $307.21.

A. That is correct.

Q. My question is, explain the $33.35, which you added to $273.86. [279]

A. Well, after the deductions, there were $273.86. I may have checked out $33.35 to make the total deposit $307.21.

(Testimony of Robert R. Webb.)

Mr. Rau would say, "Make a check out for supplies;" on the stub you will find supplies, to make it over $300 deposit. In other words, he wouldn't want to put in just $273, he would make out a check for $33.35 to make it look a little better, make it bring it over $300.

Q. So, he deposited a check for $33.25 after taking $10 in cash out?

A. I would make the check out and cash it and add that onto the deposit, to make it from $273 to $307.

Q. You drew—I don't want to interrupt you—you drew a check for $33.35?

A. That is right.

Q. And then you cashed that check?

A. I would cash it and deposit to $307, instead of $273. And I would call this, he would have me make out a check for $33.35 and mark it supplies.

Q. Well, if the check were marked supplies for $33.35, please explain how it was that you could add it to the total receipts and have a deposit of $307.21?

A. $307.21 was a deposit made as the receipts for that day; instead of deposit of $273, we made it $307. And Mr. Rau would instruct me to make out the check for, to [280] bring the amount over $300.

Q. Well now, Mr. Webb, if the check for $33.35 represents supplies, please state how it could be added to receipts to become a part of the total deposits?

(Testimony of Robert R. Webb.)

A. All I did was follow instructions on this. I didn't have anything to do with the bookkeeping. What the bookkeeper did, I don't know. This would be given to the bookkeeper, and she would have the amount of supplies taken off that day.

Q. Well, the bookkeeper didn't have anything to do with writing that $33.35 on that paper?

A. No, but she would get this after I finished the deposit.

Q. You wrote the $33.35 on there, showing the addition?

A. That is right. I was told to, instead of deposit, otherwise we would have deposited $273. So, the $33 brought it over $300, which made the deposit look better in Mr. Rau's eyes.

Q. Now, we have this then, you correct me if I am wrong, in what you said, we have Mr. Rau instructing you, as you say, to take off $10 a day. On this particular day, September 20, 1943, he now instructs you to add $33.35, just to make the deposit look good, which has the effect now of adding $33.35 to receipts that he actually did not [281] receive for that day, just to make the deposit look good.

A. The actual receipts for that day were $384.17.

Q. What was that, Mr. Webb?

A. The actual receipts for that day were $384.17.

Q. Less what?

A. Less $100.29 paid out, which is this.

Q. Yes. Who wrote these figures?

(Testimony of Robert R. Webb.)

A. That was written by the steward, or the cashier in the restaurant.

Q. So, the items comprising the $129 were all identified and written in someone else's handwriting at the French Cafe?

A. We would have vouchers to show for all this.

Q. Who had the vouchers?

A. It was brought in with the payout for this.

Q. Now, these items, now written in somebody else's handwriting, presumably the steward of the French Cafe—— A. Yes, sir.

Q. Merchandise, wages, what is this word?

A. Gunlite, that is the plumbing.

Q. Gunlite, laundry——

A. Aerated products.

Q. Aerated products, did you say?

A. It looks like that. I don't know.

Q. That is not important. Chicken, produce, oranges, [282] pies, creamery——

A. Langendorf bread.

Q. Langendorf bread?

A. French bread.

Q. French bread and golden crust wheat bread?

A. That is right.

Q. They total $129, and they are subtracted from $384.17. That leaves a total cash of $283.86; is that correct? A. That is correct.

Q. Now, this is where your handwriting comes in, $10 deducted from $283.86, leaving $273.86?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Now, a sum of $33.35 is added to that to bring a total of $307.21?

A. Yes, sir.

That was the amount of the deposit that was made in the bank.

The Court: Now, the $33.35, $33.25——

Mr. Simpson: Thirty-five cents, your Honor.

The Court: Thirty-five cents, you have testified represented cash which you obtained by cashing a check?

The Witness: I would make out a check, your Honor, for $33.35. On the stub I would put supplies.

The Court: So the stub of that check then would [283] indicate that the French Cafe had purchased supplies in the amount of $33.35?

The Witness: Yes, sir.

The Court: I suppose then that for, if that $33.35 were reflected on his returns as an additional supplies purchased, that would offset the increase in receipts that are shown on the first page of Exhibit 20, for that particular day, so that it would be an artificial entry that would just be neutralized by corresponding deduction for supplies purchased.

Q. (By Mr. Simpson): Mr. Webb, I ask what is your explanation for the $33.35?

A. Mr. Rau would ask me to, always have me make out a check to make a respectable figure to put in the bank. Otherwise, I wouldn't deposit $273.86. I don't know how the bookkeeper handled this other. I had nothing to do with that.

Q. I want to keep on that $33.35, Mr. Webb.

(Testimony of Robert R. Webb.)

A. Well, that is what I am trying to tell you.

Q. It was added to the receipts after deducting the $10? A. Yes, sir.

Q. Now, if we understand simple arithmetic, he has deposited $23.35 more than he subtracted; is that correct? [284] A. He added on $33.35.

Q. Would you answer the question; is that correct?

A. You are asking me if that was the $33?

Q. I am just going to ask you now, and I don't want to interrupt you.

The Court: I think I understand your question, Mr. Simpson, but I don't think the witness does. I suggest you rephrase it.

Mr. Simpson: All right.

Q. (By Mr. Simpson): I ask you to take that sheet right before you, September 20, to determine and tell me whether or not the figures, the total net figures show a deposit of $23.35 more than was actually deducted?

A. It shows more; yes, sir.

Q. Now, will you add the figures and put it in the record how much more it is for that day?

A. The total deposit that day was $307.21. What was left after deductions was $273.86. $33.35 added on.

Q. Mr. Webb, I will put it to you, after taking into account the $10 which you deducted in the receipts and considering the $33.35 actually added back to receipts, how much more has been de-

(Testimony of Robert R. Webb.)

posited as receipts? A. $33.35.

Q. Less—— [285] A. The $10.

Q. So that means how much more was deposited; what is the net difference?

The Court: The Court can do the——

The Witness: $33.35.

Q. (By Mr. Simpson): More that day?

A. Yes.

Q. That is what I wanted to get from you.

The Court: Mr. Webb, did that happen very often?

The Witness: Yes, sir.

Mr. Simpson: Now, if your Honor please, that happened quite often, and I can assume a lot of time in doing this, which I will do, if I have to, of course.

I want to show you Respondent's Exhibit M. These are photostatic copies of these.

Q. (By Mr. Simpson): In order to establish that for the record, I ask you to look at a daily sheet dated September 25, 1943, which is part of Petitioner's Exhibit 20 for identification, and ask you to refer to both of them now, see whether or not they are identical, if this Respondent Exhibit——

A. They are identical.

The Court: What are you comparing it with, Mr. Simpson?

Mr. Simpson: The Respondent's Exhibit M.

The Court: Which sheet in Respondent's Exhibit M?

(Testimony of Robert R. Webb.)

Mr. Simpson: Sheet dated September 25, '43, and labeled S-8. That is identical.

I would like the record to show that that is the first sheet submitted by the Respondent in connection with the withholding, that the first date appearing on the sheets in Petitioner's Exhibit 20 for identification is September 20.

Now, let's see. I will get to it faster this way.

Q. (By Mr. Simpson): S-10, tab number on Respondent's Exhibit M, that is the date of November 17, 1943; Mr. Webb, I ask you to refer to Petitioner's Exhibit No. 20 for identification, the daily sheet of the French Cafe. A. Yes, sir.

Q. Dated Wednesday, November 17, 1943. I ask you to show where any amount was subtracted as take-offs?

A. Well, probably $10 taken off the total receipts.

Q. Your Counsel has indicated to you where you might find your answer by looking on the reverse side.

A. No, no. I know that probably some others the same way.

Q. I ask you to look, the handwriting, is that your handwriting on the reverse side of this [287] sheet? A. No, that isn't.

Q. That is not your handwriting, is it?

A. I don't believe so.

Q. Now, do you know whose handwriting that is, Mr. Webb? On the reverse side.

A. No, I don't, no, sir.

(Testimony of Robert R. Webb.)

Q. On the reverse side of the daily sheet dated November 17, 1943, of Petitioner's Exhibit 20 for identification, you do not know whose signature that is?

I ask you to refer to sheet dated November 19, 1943, of Petitioner's Exhibit 20 for identification, and ask you to tell the Court where you see a deduction in any amount for that day?

A. I don't see any in there. That is not my writing.

The Court: How do you explain the fact that there wasn't $10 recorded on that sheet as having been deducted?

The Witness: Well, I was, evidently wasn't there that day, and Mr. Rau might have, whoever took it off, might have taken the cash. Probably had taken it off the total receipts, is the only way I can explain it, the only way I can explain it, because I wasn't there that day.

Q. You weren't there that day? [288]

A. It is not my writing.

Q. If you were there, you definitely would have marked it down?

A. Not definitely, I might have taken it off the total receipts, if Mr. Rau was standing there, instead of 625, might put down 615.

Q. I haven't covered this. I ask you to look at sheet dated November 20, 1943, being the original sheet of the French Cafe, and part of Petitioner's Exhibit 20 for identification, and ask you to explain to the Court the deduction, if any, on that day.

(Testimony of Robert R. Webb.)

A. Well, $110 with $470.25, and $110, which left a balance of $360.25.

Q. That is more writing?

A. That is Consumers Meat Company, $99.40, by check.

Q. Did you write that? A. No, sir.

Q. There is another item, $10.50 return from Rose. A. That is not my writing.

Q. Was that considered in the——

A. Well, I don't recall. It is 1943. I haven't any idea what it is.

Q. $10.50 return from Rose. Do you know what that means? A. No, sir. [289]

Q. Can you explain it?

A. I can't explain it. I can't remember.

Q. Can, you cannot explain it.

Do you recognize the handwriting, $10.50, return from Rose? A. No, sir.

Q. You do not recognize that handwriting?

A. No, sir.

Q. I ask you to look at daily sheet dated November 22, 1943, part of Petitioner's Exhibit 20 for identification, and ask you to identify the number 10 appearing below 2/29/39.

A. This would be my writing, 10 and this.

Q. Is this all of your writing, the 10?

A. Ten, yes.

Q. And the 1939? A. Yes, sir.

Q. I ask you to look at sheet number, dated November 24, 1943, being part of Petitioner's Exhibit 20 for identification, and ask you to explain

(Testimony of Robert R. Webb.)

the deduction, if any, claimed for that day, for the taking off.

A. That is not my writing, so I don't have any idea what it is.

Q. Is there any deduction for that day?

A. The total receipts reading of the cash register [290] was $398.07, and $1.50 tickets, receipts $396.57; paid out, $175.52; left the bank with $221.05.

Q. Is there a figure of 10 subtracted from those receipts for that day? A. No, sir.

Q. Would you please explain why there was no deduction on that day?

A. Well, whoever handled the cash that day, Mr. Rau would probably have them take it off the total receipts.

Q. You weren't there that day?

A. I wasn't there. I don't remember.

Q. You weren't there?

The Court: You mean the figure appearing opposite the word reading, namely 398?

The Witness: 07.

The Court: And 07.

The Witness: I don't——

The Court: All are represented a subtracted amount of $10?

The Witness: That is the only way I can interpret this, your Honor. It is not my writing. I evidently wasn't there that day.

Q. (By Mr. Simpson): I ask you to look [291] at——

A. That would be the same.

(Testimony of Robert R. Webb.)

Q. Sheet dated November 25, 1943, being part of Petitioner's Exhibit 20 for identification, and ask you to explain the deduction, if any, for that day?

A. The only deduction is the $41.60, for paid out.

Q. Not the $10 a day that you have testified to previously?

A. No, that is not my writing.

Q. But there was no deduction on that day?

A. Not on that sheet.

Q. And you were not there that day?

A. Evidently not.

The Court: Would you come back to that day again?

Mr. Simpson: November 25, 1943?

The Court: November 25. What was the total amount of receipts at the bottom of that page?

The Witness: $559.09.

The Court: Now, I notice underneath that there appears to have been some writing in pencil that was erased, and the erased writing appears to be visible.

The Witness: It looks like——

The Court: To my eye, the erased writing looks like $110. Would you so interpret that? [292]

The Witness: Yes, sir, it looks like——

The Court: And that, that in turn, has been subtracted from the word "bank" of $559.09, and is there still further an erased item at the very bottom of that page, which is legible?

The Witness: Yes, sir.

The Court: What is that?

(Testimony of Robert R. Webb.)

The Witness: $449.09. Looks like it is blurred over.

The Court: Well now, I have before me Respondent's Exhibit O, and ask you to turn to the entries for Thursday, November 25, 1943, and is that in your handwriting?

The Witness: Yes, sir.

The Court: What is that?

The Witness: $449.09.

The Court: Well, would that—what conclusion do you draw then from this entry on Exhibit O for the date of November 25, and the entries on the page relating to November 25, in Exhibit 20?

The Witness: Well, there is $110 taken off here. I don't know how that—I don't believe it was erased. It looks like a smudge, which leaves $449.09, which was the same as the—which was the deposit for that day.

The Court: Well then, is it your interpretation that $110 had been taken off? [293]

The Witness: Yes, sir, your Honor.

The Court: For that day?

The Witness: Yes, sir.

Q. (By Mr. Simpson): Now, the blurred writing that you have just referred to is in your handwriting? A. Yes, sir.

Q. What would be the purpose of having such a blurred handwriting?

A. I haven't any idea.

Q. Or erasure?

A. It hasn't been erased. Pencil or something like that, dark pencil.

(Testimony of Robert R. Webb.)

Q. In other words, you do not believe it was an attempt to erase that?

A. No, I don't. That was actual deposit; that would have to be that way.

Q. Now, looking at the next sheet, dated November 26, 1943, of the same exhibit for identification, I ask you to now to tell the Court where there is a deduction for $10 or any other amount?

A. No, sir.

Q. And the reason?

A. I don't know. I wasn't there that day.

Q. Not there on 26th of November. [294]

I ask you to refer to the next sheet in chronological order, being November 27, 1943, to tell the Court——

The Court: Will you turn back to the entry on November 26? What was the amount of the total shown on that?

The Witness: $423.51.

The Court: What was the total net amount?

The Witness: The net was $270.74.

The Court: What amount did you show as having been received in Exhibit O, for that day, on November 26?

The Witness: $260.74.

Mr. Simpson: That would be——

The Court: That is the $10 less than the amount appearing on Exhibit 20?

The Witness: Yes, sir; yes, sir.

Q. (By Mr. Simpson): But there was no notation or entry made on the daily sheet to reflect that?

(Testimony of Robert R. Webb.)

Well, the record speaks for itself. It isn't on there.

The Court: Does that mean that sometimes $10 was, in fact, deducted, and not put down on the daily sheet?

The Witness: It could be; yes, sir. Mr. Rau might [295] say, "Well, take $10 off the total reading, "because I know I had $10 every day, as far as I can remember.

Q. (By Mr. Simpson): Let's go to November 27. Might as well keep that Exhibit O handy.

The Court: Would you like to have it?

Mr. Simpson: Yes. Sure, you can read it out just like you have been doing.

Q. (By Mr. Simpson): November 27, and ask you to show where, if at all, there is a deduction of $10 on that day?

A. Doesn't show on the sheet; no, sir.

Q. By referring to Respondent's Exhibit O, on that same day, November 27, the receipts from the cafe of $413.62—— A. Yes, sir.

Q. The amount shown on the daily sheet, $573.62. The difference between that would be $160?

A. That is right.

Q. And that is what you withheld on Saturday, November 27, 1943?

A. This is not my sheet, but whoever took this off, took off $160 evidently. But didn't show it on the sheet is all.

The Court: But is Exhibit O in your handwriting? [296]

The Witness: This is in my handwriting.

(Testimony of Robert R. Webb.)

The Court: Exhibit O?

The Witness: That is right; yes, sir.

Q. (By Mr. Simpson): Well then, how did you know that, Mr. Webb, to take off $160 on this day, if you didn't see this similar sheet?

A. Whoever took, they—this sheet off—gave me the $150 or $160 and didn't write it on here, didn't deduct it from here. That is all.

Q. Were they supposed to deduct it from the original daily sheet?

A. Not necessarily; not necessarily, no.

Q. Well, so that there is no mistake——

A. That is all right.

Q. Whoever was supposed to take off the $160 didn't do it, I believe you said, but you did it, when you wrote it down in the day book for the French Cafe, for Saturday, November 27?

A. The day this sheet was made out, and I don't know what the date was, Saturday, I was not at the hotel. I wasn't there, or I didn't make the sheet out, but the money was taken off and given to me to put in the envelope, and I just made a deposit which was the actual deposit.

Mr. Simpson: If your Honor please, I would like [297] the record to show that the handwriting in the day book, Respondent's Exhibit O, dated Saturday, November 27, 1943, appears to have had another number or figure which have been written over by this witness.

The Court: I will state for the record that there appears to have been some other writing underneath the figure $413.62, and that that writing ap-

(Testimony of Robert R. Webb.)

pears to have been erased, and the figure $413.62 superimposed over the erasure.

I cannot tell by, at least by casual inspection what the erased figure was.

Mr. Simpson: Thank you.

Q. (By Mr. Simpson): Now, Mr. Webb, coming back to the daily sheets, calling your attention to the one dated September 21, 1943, more specifically, I direct your attention to the figure of $61.30, appearing just below the figure of $354.38, which we added to the figure preceding it, totals $415.68, as reflected thereon, I ask you now, are those figures in your handwriting?

A. Yes, they are, sir.

Q. Please explain the purpose of the addition of $61.30 to the figure of $354.38?

A. After the $10 was taken off, there was $354.38. So, I was instructed to make out a check to bring it over $300, so I made out a check for $61.30, and called it supplies. [298]

Q. And if you made a check out for $61.30 and called it supplies, how could you deposit that check?

A. Well, I could add it right on the receipts, I deposited $415. I don't remember how the——

The Court: Did you deposit the check or did you cash the check?

The Witness: I don't remember. I probably cashed the check and made a deposit of $415.

Q. (By Mr. Simpson): What account would you draw a check for $61.30 to be added to that $354.38?

(Testimony of Robert R. Webb.)

A. To make it respectable looking, deposit for that day.

Q. On what account did you draw the check?

A. On the French Cafe, French Cafe account.

Q. You drew a check on the French Cafe account for $61.30 and added it just to make it look respectable after taking $10 off?

A. I would be instructed to make a check out.

Q. Mr. Webb. I don't want you tell me what your instructions were. I asked you whether or not the $61.30 increases the receipts for that day?

A. The $61.30 increased the receipts for that day; yes, sir.

Q. Less the $10 taken off? [299]

A. Yes, sir.

Q. So, the net increase of receipts for that day is $51.30; it is a matter of arithmetic.

A. Yes, sir.

Q. We will agree on that? A. Yes, sir.

Q. I ask you to look at the daily sheet dated September 22, 1943, call your attention to the figure of $25.30, added to the sum of $308.13, and ask you if that is your handwriting?

A. Yes, it is. That would be the same as the other.

Q. Same preceding? A. Yes, sir.

Q. Daily sheet so that the net increase for the day is $15.30 over and above the actual receipts; correct? A. Yes, sir.

Q. Thank you.

I call your attention to the daily sheet dated September 23, 1943, ask you whether or not the

(Testimony of Robert R. Webb.)

figure of $10 appearing just below the sum of $244.35 is your handwriting?

A. $10 is my handwriting.

Q. And that was subtracted from the preceding figure? A. Yes, sir.

Q. Is that correct? [300] A. Yes, sir.

Q. Leaving a net figure of $234.35?

A. Yes, sir.

Q. Now, below the figure of $234.35 appears a figure of $71.30, which obviously was added to the preceding?

A. To bring it over $300; yes, sir.

Q. To bring it over $300. The net receipts over that and above that which were received on that day is $71.30, less $10 for a net increase of $61.30, over and above the actual receipts for that day?

A. Yes.

Q. I call your attention to September 24, that daily sheet dated September 24, 1943, ask you whether or not the figure of $10 appearing just below $306.10 is in your handwriting?

A. Yes, sir.

Q. Subtracting the $10 from that figure gives the result of $296.10? A. Yes, sir.

Q. Just below $296.10 is an item of $52.10, which would be, obviously from the result was added to the $296.10? A. Yes, sir.

Q. Correct? [301] A. Yes, sir.

Q. You have the net increase for the receipts of that day over and above that which was taken out would be $42.10? A. Yes, sir.

Q. In other words, you reported, Mr. Rau re-

(Testimony of Robert R. Webb.)

ported $42.10 more than he actually took in, if these figures are correct?

A. He already took, he also took off $139.36 which was actually paid out in cash from the restaurant from the total receipts.

Q. Just a minute now. He didn't take it off, it was subtracted by whoever the clerk was at the French Cafe, who put the figures down here for these various items, that total $139.36, so Mr. Rau didn't take it off, did he? A. No.

Q. You didn't mean that, did you?

A. Well, I subtracted the paid out for that day, from the total reading is what I mean.

Q. That is proper, isn't it, nothing irregular with that, about that, is there?

Mr. Gardner: May the witness be allowed to answer this, your Honor? I think he still has more to say, Mr. Simpson. [302]

Q. (By Mr. Simpson): Do you have anything more to say?

A. I think the bookkeeper would take these figures which, when she got this sheet, she would probably take these supplies off of it, charge them off to the French Cafe.

Q. Is there anything irregular about that?

A. I don't know. I have no knowledge of bookkeeping.

Q. You think she put in correct figures now?

A. I don't know how she handled that.

Q. Let's assume these figures now that you have brought it out, yourself, Pacific Freight for $1.44; see that? A. Yes.

(Testimony of Robert R. Webb.)

Q. Anything irregular with respect to that?

A. No, sir.

Q. Wages, $12.49? A. No.

Q. Anything that would arouse your suspicion?

A. No.

Q. Railway Express, 83 cents; anything there to rouse your suspicion?

A. No. What I was trying to get at is the total receipts that day for $444.46.

Q. Yes. Now—— [303]

A. We made a deposit of $348.20. How that was handled by the bookkeeper, of course, I don't have any knowledge of that.

Q. Do we have to discuss the bookkeeper with respect to these figures?

A. No, these are my figures.

Q. So, we will get a simple answer. Has not the receipts for September 24, 1943, been increased by $24.10 over and above that actually reported, according to your records that you kept?

A. Yes, sir.

Q. Thank you.

Now, calling your attention to September 25, 1943, I ask you to refer to the figure of $110 appearing just below the $483.90, and ask if that is in your handwriting? A. Yes, sir.

Q. That is your handwriting, the $110?

A. Yes, sir.

Q. That is subtracted from $483.90, leaving the sum of $373.90 as a balance; that is correct, is it not?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. The figure immediately below that is $27.20?

A. Yes, sir.

Q. Which is added to $337.90, giving a total of $401.10? [304] A. Yes, sir.

Q. Are all those figures in your handwriting?

A. They are.

Q. Please explain the purpose for the addition of $27.

A. $20.20 is put in for supplies to bring it up to $401.10.

Q. In other words, supplies are brought up?

A. Yes, sir.

Q. To that you now know, can deposit money in the bank? A. Yes, sir.

Q. Calling your attention to daily sheet dated September 27, 1943, for the French Cafe, I direct your attention to the figure of $332.78, below which there is a sum of $10 subtracted. Is that $10 in your handwriting? A. Yes, sir.

Q. The net result of $322.78 is in your handwriting also? A. Yes, sir.

Q. And there is an addition of $32.15 to that figure? A. Yes, sir.

Q. Making a total of $354.93? A. Yes, sir.

Q. Now, the addition of $32.15 was added [305] for what reason, Mr. Webb?

A. Supplies, supplies.

Mr. Simpson: If your Honor please, you want me to go all the way through this, because the same thing is going to apply all the way down. I will be

(Testimony of Robert R. Webb.)

glad to do it, if it would be of any help to the Court.

The Court: It appears to be repetitive.

Mr. Simpson: Yes, it is. But I want to show the general pattern of the adding back of these figures.

The Court: Are you going to offer Exhibit 20 in evidence?

Mr. Simpson: Yes.

The Court: The exhibit will speak for itself, I take it.

Mr. Simpson: What I could do is have a schedule made up attached to it, showing the additions which would be of help, and of course, you could go from there. I am trying to save some time.

The Court: You wish to offer it now?

Mr. Simpson: Yes.

Mr. Gardner: No objection, your Honor.

The Court: It will be admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 20 was received in evidence.) [306]

Q. (By Mr. Simpson): Very briefly, Mr. Webb, directing your attention to Petitioner's Exhibit 20, the items about which we have had discussions, that is the additions to the receipts are for supplies which have been added? A. Yes, sir.

Q. What was the source for which you obtained that information to arrive at the figure of $33.35 as

(Testimony of Robert R. Webb.)

supplies over and above the items already set out by a clerk of the French Cafe?

A. Well, the supplies, the paid out for that day, cash pay out was $100.29.

The Court: You are referring to what day now?

Mr. Simpson: September 20, 1943.

The Witness: Which left a bank balance of the bank of $283.86. $10 deducted from that made it $273.86. I added $33.35 to bring it back, the receipts for the bank at $307.21.

Q. (By Mr. Simpson): Now, you added that—strike that.

You added that $33.35 to the receipts?

A. Yes, sir.

The Court: And on that day was $10 actually taken off and put in the envelope?

The Witness: Yes, your Honor. [307]

The Court: And put in the safe?

The Witness: Yes, your Honor.

The Court: In accordance with the practice that you had previously testified to?

The Witness: Yes, sir.

Q. (By Mr. Simpson): But the net result is that you reported $23.35 more than you took in that day?

A. That was just to, as I was trying to say, to bring these, to bring our receipts for the day that would show, to bring it up over $300, and make a respectable deposit.

Q. Yes. I mean, the sheets are now more——

A. And Mr. Rau would instruct me to make out

(Testimony of Robert R. Webb.)

a check. He wouldn't—sometimes he would say make it over $300.

Q. Now, Mr. Webb, the daily sheet of the French Cafe for Monday, September 20, 1943, reflects, according to your figures, you had admitted receipts of $307.21? A. That is right.

Q. I show you Respondent's Exhibit O, being a daily book, reflecting the receipts from the bar and the French Cafe, and ask you to give the figure of receipts reported for the French Cafe on Monday, September 20. A. $307.21. [308]

Q. Now, that, of course, corresponds with the receipts that you show for the French Cafe on September 20, 1943? A. It does.

Q. Actually, $23.35 more than that was taken in that day, after making allowance for the $10 which you deducted?

A. The total receipts that day were $384.17. The money I received was $283.86. Then I took off the $10 which left the balance of $273.86. I added on $33.35, which left the deposit for, the deposit for $307.21, the same as——

Q. Which you reported as receipts?

A. Yes, sir.

Q. For the cafe?. A. Yes, sir.

Q. Now, I don't want to interrupt you, and you didn't answer my question; give you another chance at it.

The Court: I think you are arguing with the witness. I can do the arithmetic, Mr. Simpson.

Mr. Simpson: I want to make him admit it.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): Mr. Webb, I direct your attention to the daily sheet of the French Cafe dated September 21, 1943, being Petitioner's Exhibit 20, in evidence now, direct your attention to the sum of $61.30 appearing immediately below the sum of $354.38, and ask you if that is in [309] your handwriting? A. It is.

Q. And was that $61.30 added to this $354.38?

A. Yes, sir.

Q. Giving what total? A. $415.68.

Q. Now, I show you Respondent's Exhibit O, being the receipts for the bar and the French Cafe, direct your attention to the date of Tuesday, September 21, and ask you to state what the receipts were reported for that day? A. $415.68.

Q. Corresponds exactly with the receipts appearing in the original sheet of the French Cafe on the same day? A. Yes, sir.

Q. Which we considered in connection with the $10 subtracted by you, increases the receipts that day by $51.30 over and above that actually received?

A. Yes, sir.

Mr. Simpson: I have more along the same, just going to be a repetition, but maybe for the record it should go in.

The Court: The exhibit also is in evidence, and I can compare them, myself.

Mr. Simpson: Then I think this is a good stopping place for lunch. [310]

The Court: Very well. We will recess until 2:00 o'clock.

(Testimony of Robert R. Webb.)

(Whereupon, at 12:50 o'clock p.m., the hearing in the above-entitled matter was adjourned until 2:00 o'clock p.m. the same day.)

Afternoon Session—2:00 P.M.

The Clerk: For the record, petitioner's Exhibits 21, 22, 23 and 24 marked for identification.

(The documents above referred to were marked Petitioner's Exhibits Nos. 21, 22, 23, and 24 for identification.)

ROBERT R. WEBB

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Cross-Examination

(Continued)

By Mr. Simpson:

Q. Mr. Webb, I show you Petitioner's Exhibit 21 for identification, and call your attention to sheet dated January 5, 1944, and ask if the figure of $10 appearing directly under $216.82 is in your handwriting? A. That is right.

Q. That $10 is subtracted from the——

A. Yes, sir.

Q. ——preceding figure, result is $206.82?

A. Yes, sir.

Q. And right below that figure of $206.82 appears a figure of $62.30? A. Yes, sir.

Q. That is added, is it not, to $206.82?

(Testimony of Robert R. Webb.)

A. Yes, sir. [312]

Q. In that connection, I show you Respondent's Exhibit N, being the year book for the French Cafe, and the bar, for the year 1944—is that correct, 1944?

A. That is '44. I don't know.

Q. '44. I direct your attention to the entry appearing on Wednesday, January 5, the date appearing in that date book is 1938, and this particular book was used to record the receipts for 1944. Do you know whether or not that is right, Mr. Webb?

A. I don't remember the book. I don't remember.

Q. Then I ask you this, the entries appearing under date of January 5, 1938, in the amount of $269.12, is that in your handwriting?

A. Yes, it is, sir.

Q. That corresponds, does it not, to the figure appearing on the daily sheet for the French Cafe?

A. Yes, sir.

Q. $269.12. Taking these figures, the subtractions and additions, the net result is that the sum of $52.30 has been added to the receipts over and above the actual receipts for that day? A. Yes, sir.

The Court: May I see, Counsel?

(Discussion off the record.)

Mr. Simpson: If your Honor please, Petitioner has many more items similar to that, which we have been [313] reviewing with this witness. Counsel for Respondent has indicated willingness to

(Testimony of Robert R. Webb.)

stipulate to the rest of these items, and with that in mind, I request a short recess for that purpose.

The Court: We will have a recess and you notify the Clerk when you are ready to present your stipulation.

Mr. Simpson: Now, your Honor, may I offer in evidence Petitioner's Exhibits 21, 22, 23, being the day sheets for the French Cafe, for the years 1944, '45 and '46, respectively; and 24 being the day sheets of the French Cafe for the years 1944, '45 and '46 and '47, respectively.

The Court: Do these purport to be the complete set of sheets for each year?

Mr. Simpson: They are not complete sets but they are the only records that are available.

The Court: Mr. Gardner.

Mr. Gardner: No objection.

The Court: These exhibits will be admitted.

(The documents heretofore marked for identification as Petitioner's Exhibits Nos. 21, 22, 23, and 24, were received in evidence.)

The Court: There will be a recess, and when Counsel notify the Clerk that their stipulation is ready the Court will reconvene.

Mr. Simpson: Fine. Thank you. [314]

(Short recess.)

The Clerk: Recess until 10:00 o'clock tomorrow morning.

(Testimony of Robert R. Webb.)

(Whereupon, at 4:00 o'clock p.m., the hearing in the above-entitled matter was recessed until 10:00 o'clock a.m., Tuesday, July 1, 1958.)

Mr. Simpson: If your Honor please, we have stipulated with respect to the additions and deductions of the daily sheets of the French Cafe, as to what the witness Mr. Webb would testify to. That is a stipulation of facts, B.

Off the record.

(Discussion off the record.)

The Court: The stipulation will be received.

This is a stipulation as to what the witness would have testified to.

Mr. Simpson: With respect to the daily sheets of the French Cafe, as it relates to additions and deductions.

Also of stipulation of fact C, relating to the personal living expenses of Mr. Rau for the years 1942 to 1947.

Mr. Gardner: I would like to say one word about the stipulation of fact C.

It is clearly understood, I believe, that this stipulation of fact C relating to the personal living expenses is in addition to the expenses shown in the original and the first stipulation that we have, showing income tax payments.

Is that correct, sir?

Mr. Simpson: That is correct, yes.

The Court: It will be received. [318]

(Testimony of Robert R. Webb.)

Mr. Simpson: If your Honor please, at this time I would like to move for leave to amend the Petitioner's Exhibit 12, which is a photostat of Mr. Webb's bank account, which is now in evidence, consists of 12 pages and covers the year 1947. I have 36 additional sheets covering the period from December 31, 1942, to December 7, 1945.

The Court: Suppose you offer that as a separate exhibit.

Mr. Simpson: As a separate one, that would have to be through Mr. Webb.

Mr. Gardner: I haven't seen it yet, your Honor.

Might I ask if this is a complete record of all of the years previous, 1942 to November 17, 1945?

Mr. Simpson: Well, in reply to Mr. Gardner's question, I can say by examination of these sheets it does not purport to be a complete record up to 1947, which is beginning date for Exhibit 12, or for the purpose of demonstrating Mr. Webb's account beginning in 1943, up to the end of 1945, be attached to and made a part of Exhibit 12.

Mr. Gardner: I have no objection, your Honor.

The Court: I will admit the additional sheets, but since 12 is already in, the Clerk will assign another exhibit number for these additional sheets.

Mr. Simpson: All right. Thank you. [319]

The Clerk: Petitioner's Exhibit No. 25.

(The document above referred to was marked Petitioner's Exhibit 25 for identification.)

Mr. Simpson: I believe that Mr. Webb was on the stand when we finished last evening.

ROBERT R. WEBB

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Cross-Examination
(Continued)

Mr. Simpson: May we approach the bench, your Honor?

(Discussion off the record.)

By Mr. Simpson:

Q. Mr. Webb—— A. Yes, sir.

Q. I show you a group of checks, approximately 618 in number, on the French Cafe, in their account at the Bank of America for the year 1944, and ask you to thumb through the checks and tell me if your signature appears as drawer on the checks? A. One is Mr. Rau's.

The Court: Are most of them yours?

The Witness: Yes, sir.

Q. (By Mr. Simpson): Mr. Webb, so that we don't take up too much time, I now ask you to look at that group. I will withdraw the [320] one check of Mr. W. F. Rau, and ask you to take another look and state whether or not your signature appears on 617 checks?

A. Most of them are mine, but some are Mr. Rau's. There is Mr. Rau's.

Mr. Gardner: If the Court please, I think we could save time if this exhibit was going over, and the checks of—checks contained in that bunch of checks was removed by Counsel.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): Now, Mr. Webb, I will ask you to go back over that and look at those I have withdrawn.

A. You want me to pick out Mr. Rau's?

The Court: Just one at a time.

Mr. Simpson: There are approximately 600 checks there now, Mr. Webb.

The Court: Did you withdraw some of the checks from the pile, Mr. Simpson?

Mr. Simpson: Yes, approximately 17 checks.

The Court: How many?

Mr. Simpson: Approximately 17 checks. 16 I have counted. There are approximately 600 checks now remaining.

Q. (By Mr. Simpson): Mr. Webb, would you look through again?

The Court: Let the record show that Mr. Simpson is [321] withdrawing a few more checks as the witness is flipping through the pile.

The Witness: As far as I know, the rest of them are all of my signature.

Mr. Simpson: Five additional checks were withdrawn from the 16, making a total of 21 checks withdrawn from the packet of about 618 checks.

Q. (By Mr. Simpson): Now, the remaining checks there bear your signature on the French Cafe?

A. As far as I know. I can't see any others.

Q. That is for the year 1944, is it not, on the French Cafe?

A. There is one for Mr. Rau.

(Testimony of Robert R. Webb.)

The Court: Let the record show that an additional check has since been withdrawn.

Mr. Simpson: A total of 22 checks now withdrawn from 618.

The Court: Let the record also show that these checks have not been gone over one by one by the witness, but he has flipped through a rather large pile of checks, with sufficient care, however, to satisfy himself that most, if not all, of those remaining were signed by him.

The Witness: Yes, sir.

Q. (By Mr. Simpson): [322] Now, you drew the checks on the French Cafe for 1944 which you just examined? A. Yes, sir.

The Court: Are you going to ask him before you proceed to the other piles of checks what these checks were drawn for, Mr. Simpson?

Mr. Simpson: Well, yes, as soon as I establish that he has drawn these checks, then I will go back over very briefly the purposes.

The Court: Suppose we clear up the matter of this pile of checks, first.

Q. (By Mr. Simpson): Mr. Webb, in connection with the checks that you have just identified on the French Cafe for 1944, would you examine them in any way you would like, and state for the record the purpose for which the checks were drawn?

A. Well, a good many of them are payroll checks, or maybe supplies, payroll checks, supplies.

(Testimony of Robert R. Webb.)

Q. Can you look at a check and tell me whether or not it is for payroll?

A. This looks like a withholding tax. Somebody else wrote this and paid to the order—I don't know what this is. It was handed me to sign. It looks like a withholding tax.

Q. Now, let's get a check out of there that is for payroll. [323]

A. Payroll, okay. Here is a payroll check.

Q. Let the record show that the payroll check just referred to by the witness is made, check is made payable to Leon—do you know that name, last name? A. H-i-d-a-l-g-o.

Q. In the amount of $29.60.

The Court: Mr. Webb, were you the one who drew checks on the account of the French Cafe in its day-to-day operations?

The Witness: Yes, your. Honor

The Court: For the payment of expenses and other charges that were incurred by the French Cafe? A. Yes, your Honor.

The Court: Was there anyone else that drew checks in a similar capacity on the account of the French Cafe?

The Witness: The only one, only other one would be Mr. Rau, the owner, himself.

The Court: Did you draw most of them?

The Witness: The majority of them; yes, sir.

Q. (By Mr. Simpson): They were drawn for all purposes, including payroll operating expenses?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Of all kind in connection with the French Cafe? A. Yes, sir. [324]

Q. Now, that is something in addition to the merely taking of the cash receipts from the French Cafe now? A. Yes, sir.

Q. I believe your testimony is that you had nothing to do with the French Cafe, except taking the receipts. Now, your testimony is that you paid, drew checks for various sources for that operation?

A. I am sorry. I forgot about the checks.

Q. Going through the same thing again, I will show you another group of checks on the French Cafe for 1945, they have not been counted, but they appear to be 200 or 300 checks, a rough estimate.

The Court: These are for other years?

Mr. Simpson: This for '45.

The Court: Mr. Simpson——

Mr. Simpson: 1945.

The Witness: Yes, sir.

Q. (By Mr. Simpson): Have you looked at those? A. I did.

Q. Have you satisfied yourself that this group is for the same purpose that the group shown to you for 1944, represent in the way of payments of operating expenses of the French Cafe?

A. Some of these checks are by Mr. Bender, who was [325] a partner of Mr. Rau in 1946, but the rest of them look like all mine.

Q. With the exception of those few?

A. Yes, sir.

Mr. Gardner: Did I understand Counsel to be

(Testimony of Robert R. Webb.)

referring to checks for the year 1945 in his question to Mr. Webb?

Mr. Simpson: Yes, I did refer to 1945, and let the record show that there is included in there, inadvertently, some checks that have to do with 1946.

If your Honor please, these checks had been separated by dates previously, and I can now see that they have, for some reason or other, included with other dates. I am not going to spend any more time on it.

I think we have established that you did draw the checks for these various purposes for the French Cafe for 1945, 1944, 1945 and 1946?

The Witness: Yes, sir.

Q. (By Mr. Simpson): You agree to that?

A. Yes, sir.

Mr. Gardner: Might I ask also in this question Counsel has just put to the witness, referring to the year 1946, are you including the French Cafe at the time it became a partnership on May 6, 1946?

Mr. Simpson: Yes, I am. [326]

The Witness: Yes, sir.

Q. (By Mr. Simpson): And you drew checks on that partnership of Rau and Bender in 1946, did you not, Mr. Webb?

A. I believe I drew checks when Mr. Bender was a partner. I couldn't be positive.

Q. Did you also draw checks on the partnership in which you were a partner in 1947 with Mr. Rau and Mr. Bender?

A. I believe I had the authority to draw them. I

(Testimony of Robert R. Webb.)

think Mr. Bender drew most of them or Mr. Reed was the——

Q. I asked you, Mr. Webb, if you drew the checks.

Mr. Gardner: If the Court please, I would like to have Counsel instructed to let the witness answer.

Mr. Simpson: I want a responsive answer, Mr. Gardner. I asked him if he drew the checks.

The Witness: I am not sure.

Q. (By Mr. Simpson): Thank you. Mr. Webb, I am going to show you a group of checks on the French Cafe in the Anglo, California National Bank, bearing various dates in 1946, and ask you if that is your signature as drawer of those checks?

A. That is.

Q. Just thumb through those.

A. Those are my checks, my signature [327]

Q. Would you state for the record whether or not you see any checks dated subsequent to May 29 of 1946, the date on which the partnership between Mr. Bender and Mr. Rau was formed?

A. October, 1936—1946. October 31, 1946, a payroll check, October 31, 1946.

The Court: What do these dates mean?

Mr. Simpson: Subsequent to the formation of the partnership between Mr. Rau and Mr. Bender.

The Court: I understand that, but is the witness reciting those dates to indicate that there were checks made out by him on those dates?

Mr. Simpson: Yes.

The Court: Proceed.

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): Mr. Webb, did you draw checks subsequent to the time that Mr. Rau and Mr. Bender formed a partnership with the French Cafe?

A. Yes, sir.

Q. Now, I show you a group of checks bearing various dates in 1947, and ask if your signature appears on those checks?

A. Those are Mr. Bender's on some of them; most of them are my signature.

Q. And they are on the French Cafe for the year 1946? [328] A. '47.

Q. '47, I am sorry. And you were a partner in that partnership, as well, in 1947?

A. I was not in the partnership at the time these checks were written on the French Cafe.

Q. Now, that is not going to be clear for the record. Would you identify the check and give the date this check was drawn, check number?

A. Check No. 1290, drawn 6/19/47, paid to the order of Al Neal, N-e-a-d or "l," I don't know, for $59.10, signed by me.

Q. Now, your explanation as to that check, please, again.

A. I imagine that is a payroll check.

Q. And you did not draw that check at the time that there was a partnership in which you were a partner on the French Cafe with Mr. Rau and Mr. Bender?

A. The partnership of the French Cafe with Mr. Bender and Mr. Rau was sometime in the summer of 1947. The restaurant was opened for about, op-

(Testimony of Robert R. Webb.)

erated for about, maybe, two weeks or a month, and then it was closed down for remodeling.

Q. Were you a partner at that time, Mr. Webb?

A. I was a partner when we were at 1800 Chester Avenue. [329]

Q. Were you a partner with Mr. Rau and Mr. Bender on June 19, 1948, the date on which you drew this check?

A. Let's see, June 19. Yes, sir.

Q. Mr. Webb, you have testified previously that the deposits which you made in your bank account at the Bank of America in Bakersfield in 1947 came from savings, or from sale of war bonds. I ask you now, is that the only bank account that you have?

A. No. I have, we had a bank account in Beverly, I think the Beverly branch of Wilshire Boulevard. My wife had it in her name.

Q. Did you have any other bank account, yourself? A. No, sir.

Q. In your name? A. No, sir.

Q. You had no savings account in your name?

A. Not at that time, no, sir.

Q. At what time did you have your savings account?

A. All through my life I have had a small savings account. I don't recall, never amounted to very much.

Q. Did you have a savings account in 1942?

A. I don't recall.

Q. Do you recall whether or not you had such an account in 1943?

(Testimony of Robert R. Webb.)

A. I don't recall whether I had. [330]

Q. 1944? A. No, sir.

Q. Or 1945? A. No, sir.

Q. You do not recall?

A. No. I am sure I didn't have one in 1945 or 1944.

Q. You are sure you did not have one?

Mr. Webb, did you keep payroll books as manager?

A. I signed the payrolls. I didn't make out the checks, very few. I may have made out them occasionally. They are all usually made out by the bookkeeper and they were brought to me at the desk and I would sign them.

Q. You would sign the check for the payroll?

A. Yes, sir.

Q. But you never made any entries in the books as to what an employee was to receive as wages?

A. No, sir.

Q. Did not. You only made out the checks after someone gave you the information?

A. Yes, sir.

Q. Do you know Phil Bender? A. Yes, sir.

Q. What was Mr. Bender's duties; was he an employee of Mr. Rau's [331]

A. He had been an employee; yes, sir.

Q. What were his duties?

A. Well, he was a chef and steward.

Q. In what business?

A. In the French Cafe.

Q. In the French Cafe? A. And——

(Testimony of Robert R. Webb.)

Q. And was he the steward or chef for 1942 through 1947?

A. During those years he had worked there. He probably worked there couple of times, but I don't remember the years through '47 he was.

Q. Can you recall the amount of his salary in any particular year from 1942 to 1946, when he became a partner with Mr. Rau?

A. Well, I would be just guessing. I think about $400 a month.

Q. $400 a month?

A. That is just a guess now.

Q. Now, Mr. Webb, do you recall that an examination had been made of Mr. Rau's income tax returns by revenue agent Mr. Walter Slatter; do you recall such an examination? A. No.

Q. You do not. Did Mr. Slatter ever consult with you?

A. Not that I recall, no, sir. [332]

Q. Do you know whether or not Mr. Rau paid any additional income taxes as a result of an examination sometime in 1947? A. I do not, no.

Q. Just a moment, your Honor.

Well then, it is your testimony that you never saw Mr. Slatter? A. I don't remember.

Q. You do not remember. You do not recall an examination of Mr. Rau's income tax returns for 1942, 1943 and 1944?

A. I don't recall; no, sir.

Q. Coming back to the placing of the money in

(Testimony of Robert R. Webb.)

envelopes in the safe, did you see Mr. Rau open the safe and take the envelopes out of the safe?

A. Usually Mr. Rau would ask me to get the envelopes out for him. He will say, well, how much money do we have, let's get this money out and get it in the bank, or for some other purpose, but he may have gotten it out himself. He could have any time, because the bank is right there, the safe is right there; either he or I.

Q. But you did not see him take the money out of the envelopes?

A. I don't recall him taking it out; no, sir.

Q. Never saw that? [333]

A. Yes, I took it out.

Q. You took the money out of the envelopes?

A. Yes, sir.

Q. Then you handed the money to Mr. Rau?

A. I don't know whether I handed it to him or not. He was right there at the desk when the money would be there. I would make the deposit or cash it.

Q. You took the envelopes out of the safe; did you open the envelopes and take the money out and give it to Mr. Rau?

A. I don't remember handing it to him; no, sir.

The Court: Well then, in what fashion did you make it available to him?

The Witness: I would take the money out of the safe and put the money——

The Court: In his presence?

The Witness: Yes, sir.

(Testimony of Robert R. Webb.)

The Court: And put it right where, on the desk somewhere?

The Witness: On the desk.

The Court: He was there?

The Witness: Yes, sir.

The Court: Would he take it from the desk?

The Witness: He would have me put it in the bank, or take the cash, himself. [334]

The Court: Well, were there occasions when he took the money in your presence?

The Witness: Yes, sir, your Honor.

The Court: Did that happen often?

The Witness: About once a month.

Q. (By Mr. Simpson): Now, when he took the money in your presence, did he put it in his pocket?

A. Sometimes he would put it in his pocket; yes, sir.

Q. And other times, what did he do with it?

A. He would have me put it in the bank, put it in his personal account.

Q. Now, when he took the money in your presence, put it down on a table, or desk, he picked the money up and handed it back to you on those occasions when you deposited it in his personal account; is that it? A. Yes, sir.

Q. On those occasions, when he did not hand the cash or money back to you, he then put the money in his pocket; is that correct, sir? A. Yes, sir.

Q. Did you know how much money was in the envelope at the time you took it out of the safe?

A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. Now, state, if you will, on those occasions when [335] the money was not given back to you for purposes of depositing in his personal account, how much did Mr. Rau put in his pocket in cash?

A. I don't remember.

Q. Would it be as much as a thousand dollars?

A. It could be; yes, sir.

Q. Well, would it be $2,000?

A. It could be $2,000.

Q. I don't want to carry on this ad infinitum, could it be $4,000? A. I don't remember that.

Q. Don't remember that? A. No, sir.

Q. But you—it could be $2,000 at the end of a month. Mr. Rau did not give you the money for the purpose of depositing in his personal bank account, he then had the money on his person; is that correct?

A. He might put the money in another envelope, put it in the safe.

Q. He put the money back in the safe, after you took it, the envelope out?

A. He could have, but I don't recall just what, exactly what happened in every occasion. All I know is that he got the money or the bank, it was sent to the bank.

The Court: When you say he could have, you mean that [336] that happened once in a while or that it happened sometimes?

A. It happened practically every month, sir. It could have happened in the middle of the month; he could have come out and taken some money.

Q. (By Mr. Simpson): Mr. Webb, what I am

(Testimony of Robert R. Webb.)

trying to get from you is some testimony as to what happened to the cash that was taken out of the envelopes in your presence by Mr. Rau, keeping in mind specifically the occasions when he didn't give the money back to you for the purpose of putting it in his personal bank account.

I want you to tell me whether or not he put the cash in his pocket and then left the desk. Now did he do that? A. He could have.

The Court: Did he?

The Witness: Well, yes, sir.

Q. (By Mr. Simpson): That would happen more often than giving the money back to you for the purpose of depositing in his bank or can you state?

A. I couldn't state that, sir. I don't know.

Q. Would it be 50-50?

A. I couldn't state that.

Q. Well, can you give a guess as to how often you [337] saw Mr. Rau put the cash in his pocket when he didn't give it to you to put in his personal bank account?

Mr. Gardner: If the Court please, I object to the question, calling for a guess on the part of the witness.

The Court: Sustained.

Q. (By Mr. Simpson): Mr. Webb, give the approximate number of times that you saw Mr. Rau put the cash in his pocket.

A. I couldn't give you approximate number of times. I don't remember.

(Testimony of Robert R. Webb.)

Q. Then tell me, the approximate number of times that he gave you the cash to put in his personal account, now keeping in mind for the purpose of that question, Mr. Rau, that there are 12 months in a year, and 30 days, every 30 days he came down to the safe in your presence, took money out of an envelope which you had previously put in there for him and keep in mind for purposes of that question, if you will, the number of times that he gave you the cash to deposit in his bank account.

Mr. Gardner: If the Court please, I think the question is rather vague. Does he relate to one year, or does it relate to the entire period of time up to August 7, 1947? I don't know from the question.

I think that Counsel should be instructed to make the question more specific. [338]

Q. (By Mr. Simpson): In 1942, would you please state the number of times that Mr. Rau gave you the cash to go down to the bank and deposit in his personal bank account?

A. It would be at least once a month, maybe more, but I couldn't recall.

Q. That would mean then that he had no cash to put in his pocket, if it was once a month he gave you the money to put in the personal bank account?

A. He wouldn't have it all in the personal account. He might take out, in the middle of the month, for that matter, I don't know just when, but he might come out and take out $500, put it in his pocket, or put in the bank, or he could have put it in the—take it to the safety deposit box.

(Testimony of Robert R. Webb.)

Q. Well didn't you go with him to the safety deposit box?

A. I made several trips with him to the safety deposit box; yes, sir.

Q. Didn't you go with him on every occasion that he went to the safety deposit box?

A. I couldn't swear that I went on every occasion.

The Court: Did you go on most occasions?

The Witness: Yes, sir, your Honor. [339]

Q. (By Mr. Simpson): In 1943, please state the number of times in a year that Mr. Rau gave you cash for the purpose of depositing in his personal bank account?

A. I don't know; I don't remember.

Q. In 1943, please state the number of occasions that Mr. Rau gave you cash for the purpose of putting it in his personal bank account?

A. I don't remember.

Q. In 1945, please state the number of occasions that Mr. Rau gave you cash for the purpose of depositing it in his personal bank account?

A. I don't remember.

Q. In 1946, please state the number of occasions that Mr. Rau gave you the cash for the purpose of depositing in his personal bank account?

A. I don't remember.

Q. In 1947, please state the number of occasions that Mr. Rau gave you cash for the purpose of depositing in his personal bank account?

A. I don't remember.

The Court: But do you remember that you did

(Testimony of Robert R. Webb.)

deposit amounts that he gave you in each of those years?

The Witness: Yes, your Honor.

The Court: And what is it that you don't remember, the number of occasions? [340]

The Witness: Yes, sir.

Q. (By Mr. Simpson): Now, do you remember the amount of cash that he gave you to put in the personal bank account on these occasions?

A. I do not remember the amounts, no, sir.

Q. Can you approximate the amount of cash that he gave you to deposit in his personal bank account?

A. I might—he might give me a thousand dollars, or he might give me $300, if it is 30 days; $750 if it was 60 days, and put that all in his account. I don't remember exactly. He may have had more than that.

Q. Mr. Webb, I show you Petitioner's Exhibit 11, being the personal bank book of Mr. Rau, in the Bank of America; I believe you previously testified that you made or took the cash on most of these occasions for the purpose of depositing in that account as reflected in that book; isn't that true?

A. Yes, sir.

Q. Directing your attention to the date of December 25, 1942, deposit of $2,450, and ask if you can recall that occasion on which you made that deposit?

A. No, I can't recall it.

Q. Looking down further in the book, January 7, 1943, there is a deposit of $2,000 in the personal bank [341] account of Mr. Rau, do you recall the occasion when that deposit was made?

(Testimony of Robert R. Webb.)

A. No, sir, I don't recall any of the occasions.

Q. Can you look in this book and tell the Court when you, if you made any of the deposits that you see reflected in that account?

A. I made quite a few deposits, but I don't recall any specific one. I know I deposited most of his money for him.

Q. If there was a large amount of cash in your pocket at the time you went to the bank, would not that be something that you remember?

A. Not particularly, no, because I was, I handled quite a lot of cash for Mr. Rau.

Q. In other words, you had in your possession a large amount of cash at all times?

A. Not at all times, but several times I had large amounts of cash that I would go up to the bank and either bring back or take to the bank, large amounts of cash; yes, sir.

Q. Now, Mr. Webb, did anyone see you put the cash in the envelopes when you put the envelopes in the safe?

A. They may have, but there wasn't any, I didn't ask anybody to watch me put it in or anything like that.

Q. Who else was there that could have observed your [342] putting the cash in the envelopes?

A. Well, Mr. Rau could observe me, or Miss Goldstein could, or bellboy could, or the other clerk could. He is right there in the office, the safe.

Q. Would they know how much cash you put in the envelope?

(Testimony of Robert R. Webb.)

A. No. There is no reason why they should know; no, sir.

Q. Would they also see Mr. Rau take the money out of the envelope, right there in the office, with all these employees?

A. They could have; yes, sir.

Q. Well, were they there at the time Mr. Rau took the money out of the envelope?

A. I don't remember, maybe sometimes they might have been, maybe not. I don't remember.

Q. Can you state whether or not they were there when you put the cash in the envelope?

A. I don't remember.

Q. If Mr. Rau did not give you the cash for the purpose of depositing in his personal bank account, and took the money out of the envelope in your presence, as you have stated, he then had the money on his person when you last saw him and the cash?

A. He might have had it on his person, or he might [343] have put it in his own, in his safe for himself.

Q. In what safe, Mr. Webb?

A. In the office.

Q. He would put it back in the safe, do you mean? A. He could have; yes, sir.

Q. Well, you were right there, did you see him put it back in the safe?

A. Yes. Occasions I have seen him put the money in the safe.

Q. And how often would that be; would that be a

(Testimony of Robert R. Webb.)

general practice, let me ask you the question that way? A. Yes, sir.

Q. That would be the general practice, that is, that money would go back into the safe, except on those occasions when he gave you the cash to put in his bank account?

A. He might have put it in his pocket. He might have sent me to the bank with it, or he might have put it in the safe.

Q. Of course, there are many, many possibilities, and I am trying to rule out certain possibilities, Mr. Webb, so that we can identify or establish rather, exactly what happened to that cash in your presence that you have been testifying here for three days, that you took that cash out so much money a day, there was no question or hesitance about your testimony in that regard. [344] A. Yes, sir.

Q. Now, I am going to try and find out from you where it finally ended up, where it went, and you are the man that can do it.

You gave him that cash or made it available to him by putting it on a desk? A. Yes, sir.

Q. On some occasions he gave you that cash, you knew how much was in the envelope, you have already stated that. A. Yes, sir.

Q. And you took it down and put it in his bank account, personal account; is that correct, so far?

A. At times, not every month it wouldn't happen.

Q. Well now, when it didn't happen——

A. He may have put——

(Testimony of Robert R. Webb.)

Q. ——the cash was there, Mr. Webb, on the table, what did Mr. Rau do with it then?

A. He might have put it in his pocket.

Q. Well, did he put it in his pocket?

A. Sometimes.

Q. And on other times, what did he do with it?

A. He might have put it in the safe.

Q. Did he, did you see him put it back in the safe?

A. I have seen him put it back in the safe; yes, sir. [345]

Q. Right back again?

A. Maybe that, not that amount, some in his pocket. I don't recall just exactly how it happened. Maybe all of it.

Q. When he left you on occasions, when he didn't put it back in, then is it safe to assume so far as you are concerned, that it was on his person when you last saw the cash, or knew of its disposition?

A. I really didn't pay much attention what he did with the money after I gave it to him.

Q. Well, please state how much attention you paid to the cash when it came out of the safe; did you count it? A. It was counted; yes, sir.

Q. Now, it was counted 12 times a year, every month? A. Yes, sir.

Q. Was it counted every day?

A. Not every day. It wouldn't be necessary to count every day.

Q. Well, when you took $10 off——

A. I would put it in an envelope.

(Testimony of Robert R. Webb.)

Q. Put it in the safe; did you know how much was in that envelope at that time? A. Yes, sir.

Q. Could you look at that envelope on any [346] given day during that month and tell how much cash was in that envelope? A. Yes, sir.

Q. You could?

A. Just by the number of days.

Q. You counted every day then, did you not?

A. I don't know whether I counted every day. I put it in the envelope every day. I knew how much it was in there, because if it was the 10th of the month, I knew there would be $100.

Q. There was some money left over in that envelope? A. There would be another envelope.

Q. Another envelope?

A. I had two envelopes with $10 a day in one envelope, $25 a day in the other envelope. Anything else that was taken out would be put in another envelope, and marked on the envelope how much was taken out, the amount, and the date. That would be turned in to Mr. Rau. He might come up two days later and take it all away, take it out; then we start another envelope.

Q. If he took all that cash out, he did it when you weren't there then?

A. He could have; yes, sir.

Q. Well, did he?

A. I don't recall that; I don't know. [347]

Q. Do you ever recall an occasion when you went in in the end of the month, opened an envelope and saw no money in it at all? A. No, I don't.

(Testimony of Robert R. Webb.)

Q. Well then, you had to count the money every day then to be able to tell on any given day how much money was in the envelope; didn't you?

A. No, I didn't have to count it every day.

Q. Then how did you know how much was in there on any given day then?

A. Well, the envelope I put $10 a day in, it was the 10th of the month, I know there would be $100. I might count it; there would be no necessity for counting it, because he never touched those envelopes.

Q. Which ones did he not touch now?

A. He would never touch the one with the $10 a day or $25 a day, that I recall.

Q. Which ones did he touch?

A. He would touch, he might take the money out of an envelope that was the $100, or might take $100 out on a Saturday. He might take that.

Q. Now, we have three different envelopes now?

A. At least three; yes, sir.

Q. You had at least three, you had one that had $10 a day in it, one that had $25 a day in it, and a third [348] envelope now that had $100 on Saturdays and Sundays? A. Yes, sir.

Q. Is that it? A. Yes.

Q. Now——

The Court: I thought you had testified as to four envelopes; one on the $10 a day, one in which you deposited the $10 a day from the French Cafe, and a second one which you put $25 a day from the bar, a third one in which you put the unusual amounts

(Testimony of Robert R. Webb.)

from the French Cafe—that is the amounts that were taken on week ends, or on days when it was busy, and a fourth one in which you put the unusual amounts that you took off from the bar.

Now, if I have misunderstood about you, about these four envelopes, will you please make it straight now.

The Witness: There is one envelope for the coffee shop, French Cafe, $10 a day; one for the bar, $25 a day; another envelope, if I took out $100 on the week ends.

The Court: From what?

The Witness: From the restaurant or the French Cafe.

The Court: Then the third envelope was for unusual amounts that came from either the French Cafe or the bar?

The Witness: Yes, your Honor.

Q. (By Mr. Simpson): Well now, did you know how much was in the third [349] envelope containing the so-called unusual amounts taken off?

A. Yes, sir.

Q. And how often did you count the money that was in that envelope?

A. If I put any money in that envelope, I would put the date and the amount on the envelope.

Q. So then, you knew each day how much was in the envelope? A. Yes, sir.

Q. Now, if I understand you correctly, Mr. Rau did not touch the envelope that had the $10 a day in it?

(Testimony of Robert R. Webb.)

A. As I recall, he never touched that envelope, or the one with the $25 a day. He might have taken out of the other envelope.

The Court: That is the third one?

The Witness: Yes, your Honor.

Q. (By Mr. Simpson): The third envelope?

A. Yes, sir.

The Court: Did you ever take moneys out of the first two, that is the $10 a day envelope, or the $25 a day envelope at the end of the month and transfer those aggregate amounts into the third envelope?

The Witness: That could have happened. I don't recall [350] just how, or the occasions.

Q. (By Mr. Simpson): If it did happen, Mr. Webb, you would have to know it, though, wouldn't you? A. He might take the three envelopes.

Q. I want you to answer the question: if it did happen, where he took the money out of the first two envelopes, containing the $10 a day and $25 a day, and transferred that money into the third envelope, you would know that, wouldn't you, Mr. Webb?

A. Yes, sir.

Q. Now, if he did that, then you would of course know it. Now, since you knew it at the end of the month, was there an occasion when there was no cash in the $10 envelope and no cash in the $25 envelope?

A. At the end of the month; yes, sir.

Q. There would be no cash in it?

A. That is right.

Q. You recall that?

(Testimony of Robert R. Webb.)

A. I recall it, that would be all taken out. We would start new envelopes on the first of the month.

Q. Two new envelopes, though?

A. Two new envelopes, yes.

Q. Now, all the money was in one envelope, the third envelope? [351]

A. The third envelope we would take it all out. He might have me take the whole amount of the three envelopes and deposit them, or do most anything else with them. I don't recall.

Q. Well now, on that third envelope, could you look at it and tell how much money was in there on any given day? A. Oh, yes, sir.

Q. You could? A. Yes, sir.

Q. Now, you tell the court exactly how you could tell on any given day the amount of cash that was in that third envelope?

A. Because I would mark on the envelope the amount and the date, and if Mr. Rau took any out, he would cross it off, or tell me. Then I would count it.

Q. Please state how you knew that he took any money of the $10 envelope and out of the $25 envelope, and transferred the contents of those two into the third?

A. I didn't say that he took it out of the $10 envelope or $25 envelope, the third envelope. He might come down in the middle of the month and say put this money in the bank, or put it in some other private use; wouldn't necesarily have to be the last of the month on the third envelope. [352]

Q. Didn't you just get through testifying that

(Testimony of Robert R. Webb.)

he took money out of the $10 envelope and $25 envelope and transferred it to the third?

A. At the end of the month he might put it altogether, the three envelopes, and deposit it all in the bank, or for some other purpose, which I wouldn't know.

Q. Did that third envelope have a notation in your handwriting as to the amount of money that was in that third envelope? A. Yes, sir.

Q. Then was it not necessary for you to look in the first and second envelopes to determine that there was no cash in them that had been transferred to the third envelope so that you could have an accurate count of the money in the third envelope?

A. Well, as far as I know, there was never anything taken out of the two envelopes during the month.

Q. Never anything taken out of the first and second envelopes? A. That is right.

Q. During the month? A. Yes, sir.

Q. Now, when the contents of the first and second envelopes were transferred to the third envelope, the contents of the first and second envelopes transferred to [353] the third that is, did you count the money at that time when it was transferred?

A. At the end of the month, if there was any money in the other envelope, the third envelope, it would probably be put together, either deposited in the bank, or Mr. Rau might take it for some other use, put it in his own personal account, or for most anything. I don't know.

(Testimony of Robert R. Webb.)

Q. When you took the envelopes out to make the cash available to him, then you took it out of the third envelope?

A. If there was any money in the third envelope, it was all taken out; yes, sir.

Q. And you put it on a table, the cash, and Mr. Rau took part of it?

A. He might take part of it; he might not.

The Court: What table was this, and where was the table?

The Witness: The front desk, your Honor.

Mr. Simpson: At the front desk.

The Court: Is this a table behind the desk, or was this the desk, itself, that you are referring to as the table?

The Witness: Yes. We had a desk in the little, desk in the back office, and usually he would, we would count it back there, or if he had any deposits, he had the amount [354] right on the deposit book, which we knew that it was okay.

Q. (By Mr. Simpson): What was the cash doing out on the front desk then?

A. It could have happened in the front desk. We had a desk to register on. Over here we had a little desk for our room rack, which is enclosed. Could have been counted there, could have been counted in the back office on the desk.

Q. Well, I think you testified, Mr. Webb, that the cash was out in the front, on the front desk?

A. Could have been the front desk, or the back desk; I don't remember.

(Testimony of Robert R. Webb.)

Q. Well, this happened at least 72 times, can't you remember where it happened most of the time?

A. Usually in the front.

Q. Usually right out there in the front?

A. In back of the room clerks, in back of the room rack; yes, sir.

Q. It didn't happen——

The Court: Would this be visible to anybody in the lobby, to any strangers passing through the lobby?

The Witness: Yes. The whole office was visible for anybody in the lobby. [355]

Q. (By Mr. Simpson): Then there was an office in addition to the front desk where the cash was placed when it was made available to Mr. Rau?

A. I don't quite get you, sir.

Q. In addition to the front desk, there was also an office?

A. It was just one office, but it was a little in the rear of the office. We had the safe and another desk and a couple of chairs, and a desk, and also some files for records.

Q. Now, when Mr. Rau took part of the cash and left, the last you knew of it then it was on his person?

A. He may have put it, been on his person, or he may have put it in the safe in his own envelope. His own, he had a little box.

Q. There was another envelope?

A. In this big safe, there was one box that he could lock with a little separate compartment.

(Testimony of Robert R. Webb.)

Q. Little drawer, did it have a key?

A. He had a key; yes, sir.

Q. Did you have the key?

A. Not to that; no, sir.

Q. Then at no time did you ever know how much cash was in that little box?

A. No, I didn't. [356]

Q. And that safe was kept in the front part of the hotel at the front desk?

A. It was in the lobby of the hotel.

Q. The lobby?

A. It was in the back of the room clerk's office.

Q. So at no time then did you know how much cash was in that drawer?

A. I don't remember any time, no. I may have, but I don't recall it.

Q. Did you see Mr. Rau put it in there, cash?

A. Oh, yes. He kept money in there; yes, sir.

Q. You saw him put it in?

A. Probably did. I was around there all the time.

Q. If he put it in there, did you ever see him take it out?

A. He had some money in there several times. I don't know how many times, but he would take thousand dollar bills, we would go down to the Anglo Bank and he would put it in the safety deposit box.

Q. Where did he have the thousand dollar bills?

A. They would be in the safe.

Q. Do you know how they got in the safe?

(Testimony of Robert R. Webb.)

A. He would put it out in the safe. If I went to the bank and got two thousand dollar bills or four one thousand dollar bills, I would bring it back to him, and [357] he would take the money and put it in the safe.

Q. When you got the one thousand dollar bills from the bank, did they make a record of it?

A. Did the bank make a record?

Q. Yes. A. I wouldn't know.

Q. Did this occur in 1942, the getting of these thousand dollar bills?

A. I don't believe so. It seemed to me it was later on, but it could have been.

Q. How much later, now, Mr. Webb?

A. I don't know. It was during the war years, all I can recall, or after the war.

Q. During the war years? A. Yes.

Q. Now, when you went down to the bank to get a thousand dollar bill, or four one thousand dollar bills, did you just put four thousand in cash in the, to the teller, hand you four one thousand dollar bills right at that moment, sir?

A. If it was four thousand, he would hand it to me; yes, sir.

Q. He did. Did he make any record of the serial numbers on the thousand dollar bills on those occasions?

A. The bank may have. I never made any record, no. [358]

Q. Did you see the teller make a record?

(Testimony of Robert R. Webb.)

A. I don't recall. I didn't pay any attention to what the teller was doing.

Q. Did he ask you your name when you got the thousand dollar bills?

A. No. Most of the tellers knew who I was. I worked for Mr. Rau.

Q. So, for their records of getting a thousand dollar bill, they didn't make any notation as to——

A They may have, but I wouldn't know.

Q. You don't know that?

A. No. I don't pay any attention to that.

Q. Mr. Webb, do you know Jack Longway?

A. Yes, sir.

Q. Have you ever been in business with him?

A. No, sir.

Q. Never been in business with him?

A. No, sir.

Q. Have you ever been in a mine deal of any kind, mining deal, mining operation?

A. Not that I recall, no.

Q. Do you have any present business connections with Mr. Longway? A. No, sir.

Q. How well do you know Mr. Longway? [359]

A. Well, I used to know him quite well. He was in the service, when he came out I haven't seen Mr. Longway, probably in, maybe five years. I don't—maybe longer than that.

Q. He was in the service until when?

A. I believe he was in the Navy during the war, part of the war, anyway.

Q. What was his rank in the Navy?

(Testimony of Robert R. Webb.)

A. I think when he came out he was—I don't know whether he was Chief Petty Officer. I knew he was Petty Officer.

Q. He was a Petty Officer?

A. He may have been a Chief Petty Officer. I don't recall.

Q. Do you recall the year that he left the Navy?

A. No, sir.

Q. Do you have any present business associations with Miss Rose Goldstein? A. No, sir.

Q. Have you ever had? A. No, sir.

Q. Did you ever work with Miss Rose Goldstein?

A. Yes, sir.

Q. For—Mr. Webb, I mean for Mr. Rau, I am sorry. A. Yes, sir. [360]

Q. She was an employee of Mr. Rau?

A. She was employed, I think, part-time by Mr. Rau.

Q. Part-time. Was Miss Goldstein married at that time?

A. I don't—Miss Goldstein was married to Mr. Longway, but I don't recall the year or the date, or what just exactly what it was. I think it was after the war.

Q. You don't recall the year? A. No.

Q. In which Miss Goldstein married Mr. Longway?

A. We always called her Miss Goldstein or Rose.

Q. Do you know whether she goes under both names, that is Miss Rose Goldstein, and also Mrs. Jack Longway?

(Testimony of Robert R. Webb.)

A. I believe she may have her business name as Miss Goldstein, but I haven't seen Miss Goldstein until I saw her down here, within I guess a couple of years, and that was at least two years.

Q. Been at least two years since you have seen her?

A. Until I saw Miss Goldstein at the courtroom here.

Q. At the time you made the entries on the daily sheets of the French Cafe, you knew, did you not, at the time you made them, that they were false?

A. Yes, sir. [361]

Q. And you made them every day for 365 days a year, except on those occasions that you were not there? A. Yes, sir.

Q. And on those occasions, the entries, if any, were made by whom?

A. Well, they probably were made by Miss Goldstein.

Q. By Miss Goldstein. Would you please explain, if you will, please, your account of making a record of these false entries for each of the years 1942 through 1947, to 1947, inclusive?

A. I don't quite understand.

Q. What was your reason in making these records as you have testified to, in connection with the daily sheets of the French Cafe?

A. I was instructed by Mr. Rau.

Q. Now, since you were instructed by Mr. Rau, you felt that there was no alternative open to you but to falsify the records?

(Testimony of Robert R. Webb.)

A. No, I could have quit.

Q. You could have quit?

A. Or I could have gone and informed on him, I suppose.

Q. Have you informed on him?

A. No, sir. I never did inform on him; no, sir.

Q. Well, don't you think you should have? [362]

A. Probably should, yes. But I just didn't, did not inform on him.

Q. You are quite certain of that?

A. I am positive of it.

Q. Positive of that? A. Yes, sir.

Q. Now, every day that you wrote down that false entry, you knew that it was false. Please explain how you were able to consent to that false act of cheating your Government knowingly.

A. Well, I didn't realize I was cheating the Government, myself. I thought that was up to Mr. Rau. I was just following his instructions. I knew it was wrong, but at the time I didn't realize that I had anything to do with how he made out his income tax, or just what he did.

Q. So now your explanation is, if I understand you correctly, if I am wrong——

A. My explanation is that I did not inform, or I did not have anything to do with it.

Q. I want to come back to these entries that you made every day, these records. Did Mr. Rau instruct you to make the records that we have here in evidence?

(Testimony of Robert R. Webb.)

A. He instructed me about the $10 a day, and the $25 a day; yes, sir. And—— [363]

Q. Did he instruct you to make a record of that, as we have seen here in evidence on the daily sheets of the French Cafe? As a matter of fact, you have a photostat Respondent's Exhibit M, right before you of those daily sheets showing the amounts taken off each day.

Did he instruct you to make that entry showing $10 taken off that day? A. Yes, sir.

Q. He told you to keep a record of his cheating?

A. No, he didn't tell me to keep a record of it; no, sir. I never new these were in existence. As far as my part of it, I just turned these over to the bookkeeper.

Q. You did not know that the——

A. I wasn't even interested whether they were, or anything about it. I just turned them over, after he got through with it, he would consult with Miss Goldstein, practically every day.

Q. You didn't know anything about the daily sheets of the French Cafe reflecting the $10?

A. Yes, sir.

Q. Then I ask you again, did Mr. Rau tell you to make the entry on the daily sheets showing that the $10 was taken off that day?

A. No. I don't recall him telling me how to do it.

Q. Well then, it was your voluntary act of recording [364] it all on your own to demonstrate the fraud against your Government, without any in-

(Testimony of Robert R. Webb.)

structions from Mr. Rau to make the entry of his cheating?

A. The reason I made the entry, so Mr. Rau could see exactly what it was.

Q. Well, he knew, didn't he?

A. He could tear it up after I got through with it. I don't care.

Q. Well, he told you, Mr. Webb, to take it off according to your testimony, he already knew. Now, tell me why you kept the record voluntarily on a daily basis, showing the amount taken off on the French Cafe? A. The minute I was——

Mr. Gardner: If the Court please, the witness has answered that question twice before, and I think it is now becoming just an argument between Counsel and the witness. I object to the question.

The Court: Were these sheets turned over to him every day; did he see them?

The Witness: I imagine he saw them every day, sir, every day he was downstairs, or if he was in his room, they would be taken up to his room and Miss Goldstein, the bookkeeper, would get it after we got through with it.

The Court: Well, these sheets were taken up to his room on occasion? [365]

The Witness: On occasion, yes, sir.

The Court: And on occasions, were given to him in some other fashion?

The Witness: Just the way it is here.

The Court: With your handwriting at the bottom showing the amount taken off?

(Testimony of Robert R. Webb.)

The Witness: Yes, sir.

The Court: So, this was a practice you were engaged in with his knowledge and consent?

The Witness: Yes, sir, your Honor.

Q. (By Mr. Simpson): So then in effect Mr. Rau told you to continue the practice of demonstrating and establishing his cheating, he liked it?

A. Evidently.

Q. Is that it, he definitely wanted you to keep that record after he saw it, he said "This is fine, keep it day after day"?

A. He didn't tell me to keep any records. I didn't keep any records.

Q. You didn't keep any records?

A. I didn't know what happened to this after I got through with it. First time I have seen these sheets since I worked for him.

Q. But you put the figures down on there, [366] didn't you? A. Yes, I did.

Q. You have testified it is in your handwriting?

A. Yes, sir.

Q. You made the deductions?

A. That is right.

Q. Now, you took them upstairs to his room, and showed it to him. He says, "Well done, keep it up;" is that it? A. He didn't say anything.

Q. He didn't say anything after you showed it to him. You said, "Here, Mr. Rau, I have a perfect record of your cheating."

Mr. Gardner: If the Court please, there has been no such testimony as "Here Mr. Rau, here is a per-

(Testimony of Robert R. Webb.)

fect record of your cheating," or anything like that. He is trying to put words in the witness' mouth, and it is arguing.

The Court: It is cross-examination, but it is, I think, it is unfair. Proceed.

Mr. Simpson: Perhaps, your Honor——

The Court: I think you were, you are taking liberties with his testimony, when you undertake to characterize it, as you do.

Mr. Simpson: All right. Then I will cover it this way then. [367]

Q. (By Mr. Simpson): You took the records up to his room, did you?

A. On occasions. Mr. Rau was, sometimes he would stay in late, maybe I wouldn't—at times I wouldn't know whether he had been down at all that day.

Q. I have it down here, I made a note. We will go back and get the reporter to read it.

The books were taken up to his room, to Mr. Rau's room.

A. There was occasions when they were; yes, sir.

Q. You took them up then?

A. On occasions, yes, sir.

Q. Well now, after you made the entries on those daily sheets, you said you never saw them again? A. They were given to Miss Goldstein.

Q. All right. Now——

A. This sheet——

Q. What did you do, did you give them to Miss

(Testimony of Robert R. Webb.)

Goldstein after you made the entries, or did you take them upstairs and show them to Mr. Rau?

A. I, if I showed it to Mr. Rau, I would have to give it to Miss Goldstein; otherwise, she wouldn't have, couldn't have gotten it.

The Court: Who got them first?

The Witness: Mr. Rau. [368]

The Court: Was that on most occasions?

The Witness: Yes, sir.

The Court: Then they ultimately wound up in Miss Goldstein's hands?

The Witness: Yes, sir.

Q. (By Mr. Simpson): Now, you showed them to Mr. Rau first, so he saw that you were keeping a record of his cheating. When you handed it to him, what, if anything, did he say when he saw that perfect record that you had made?

A. He was interested in how much money, what the receipts were and what the pay outs were, and there was nothing said about that, as I remember.

Q. Well, couldn't you have shown him another record showing him what the receipts were, the daily records that you kept, they were in evidence for the bar and the cafe, couldn't you have shown him that?

A. Yes, I could.

Q. Well then, why is he interested in the daily sheets of the French Cafe?

A. Naturally, Mr. Rau would like to see what was taken in in the French Cafe and in the bar.

Q. Well, I thought that was reflected——

(Testimony of Robert R. Webb.)

A. It wasn't one day that he didn't see the whole record. [369]

Q. I thought that you kept a perfect record of that in these date books, showing both operations, the bar and the cafe? Let's just take Respondent's Exhibit O, just any date. Here is Wednesday, July 7.

A. That is right.

Q. And that is for 1943, the receipts for the bar $256.07, for the cafe $383.09. Now, if he was interested in receipts, couldn't you have shown him that?

A. That would not give him a true picture of the receipts; the reason I didn't show him that.

Q. Wouldn't give him a true picture of the receipts?

A. No. If I showed him $256.07, he wouldn't know what that meant.

Q. He wouldn't know that meant receipts from the bar, if you told him?

A. I could tell him that, but he wouldn't, naturally he would want to see what the, see the tapes and the pay outs and everything.

Q. Oh, he audited everything after you finished?

A. He would want to look at them, see what it was.

Q. Did he add them up?

A. I don't know whether he added them up. I gave it to him.

Q. You gave him all those tapes?

A. Gave him the tape, and I would write on it— [370] Well, this record right here, I would give it to him, take it right——

(Testimony of Robert R. Webb.)

The Court: By this record right here, you are referring to Exhibit M?

The Witness: Yes, your Honor.

Q. (By Mr. Simpson): Now, he had the tapes, you gave him the tapes; what did they show to him?

A. The tapes showed him the total amount of receipts for the day.

Q. For the day.

The Court: You mean actual receipts?

The Witness: Actual receipts; yes, your Honor.

Q. (By Mr. Simpson): Then how did you show him the pay outs?

A. Well, the restaurant, here was the pay outs. If there is anything paid out in the bar, practically everything in the bar was paid by check. There was very little pay out, just a matter of little incidentals like a box of limes, or ice, or something like that. That would be deducted from the total receipts.

The Court: That is the bar?

The Witness: Yes, sir.

The Court: What about the French Cafe?

The Witness: The French Cafe was all on here. [371]

The Court: On here, you are referring to what?

The Witness: The paid outs.

The Court: You are referring to, again to the sheets on Exhibit M, which is before you?

The Witness: Yes, sir.

The Court: There will be a short recess.

(Short recess.)

(Testimony of Robert R. Webb.)

Q. (By Mr. Simpson): Mr. Webb, when you took the daily sheets of the French Cafe up to Mr. Rau, did you also take, at that time, the tapes?

A. Yes, sir.

Q. Did you take any cancelled checks?

A. Any cancelled checks?

Q. Yes. A. Not that I recall.

Q. Did you take any journal records?

A. No, sir.

Q. Take a general ledger? A. No, sir.

Q. Now, exactly what did you take up to Mr. Rau's room after you made the entries on the daily sheets for the French Cafe?

A. Just the cash sheets from the French Cafe, with the tapes. [372]

Q. With the tapes. Did you leave the tapes in his room? A. Yes, sir.

Q. Did you leave the daily sheets in his room?

A. I don't believe I left this daily sheet in his room. I would bring it down and either give it to Miss Goldstein, or put it where she could pick it up.

Q. But you made certain that Mr. Rau saw the amount taken off, according to your records?

A. It would be given just exactly the way it is here; yes, sir.

Q. He knew that you were keeping this detailed account of the falsification of the receipts?

A. Yes, sir.

Q. He knew that. Now, did he tell you to continue that practice? A. Yes, sir.

Q. So from that time forward, by the way, let's

(Testimony of Robert R. Webb.)

establish the first time that Mr. Rau knew that you were keeping this detailed account of falsifying the records. A. It would be sometime in 1942.

Q. Sometime in 1942? A. Or prior to that.

Q. Prior to 1942 he knew that you were keeping that record of the cheating? [373]

A. I did not keep the records. I just gave it to him and that was all. He knew that I took off that much money.

Q. Now, at the bar, I am not sure that I understand your testimony. I don't want to have any mistakes about it. As to the expenses that were paid at the bar, paid outs, you said he was interested in that, too?

A. The pay outs in the bar were practically all by check, with the exception of ice and incidentals.

Q. So that you would have cash pay outs at the bar in small amounts? A. Yes, sir.

Q. Now, when you had the other expenses at the bar, you said they were paid by check and did you make the checks payable to the supplier?

A. Yes, sir.

Q. You wrote the check out to the supplier's name? A. Yes, sir.

Q At the bar. Mr. Webb, I have counted these checks personally. I think that we can safely say there are 159 checks, the Southern Wine and Liquor Company for the year 1944. I ask you to take a look at those checks, please, and tell me if your signature appears thereon as the drawer of these checks, please? [374]

(Testimony of Robert R. Webb.)

A. Yes, sir, all but two. I think Mr. Rau's name is on them.

Mr. Gardner: Would you speak up, please?

Mr. Simpson: So the Reporter can get it.

The Witness: I think I saw one for Mr. Rau in here. There it is.

Q. (By Mr. Simpson): Is that Mr. Rau's signature? A. Yes; it is.

Q. Here is another one with Mr. Rau's signature, check No. 79, dated March 18, 1944; is that Mr. Rau's signature? A. Yes, sir.

Q. The other one you just identified as Mr. Rau's signature, check No. 110, dated April 1, 1944, on the Southern Wine and Liquor Company?

A. Yes, sir.

Q. Both of those checks. I ask you again to look at this group of checks now, totaling 157, run through them, if you will, and tell me the name, if any, of the payee of the check?

A. I don't see any payees on here.

Q. This, the checks were all made payable to cash? A. Well, that is right.

Q. Can you, by looking at those checks, explain the [375] purpose for which they were drawn?

A. You would have to get the stubs. I can't explain it; no, sir.

Q. In other words, if you were furnished with the stubs, you could explain these checks that are drawn to cash?

A. If I could look at the stubs, yes.

(Testimony of Robert R. Webb.)

Q. Let's see if I can get the stubs for you of those checks.

Would you mark this, please, as Petitioner's Exhibit next in order?

The Clerk: Petitioner's Exhibit 26 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 26 for identification.)

Q. (By Mr. Simpson): Mr. Webb, I hand you Petitioner's Exhibit 26 for identification, being check stub, Southern Wine and Liquor Company, and direct your attention to check stub 260, and ask if that is your handwriting? A. It is.

Q. Now, the notation on that check stub is to cash? A. That is right.

Q. For supplies. Now, I ask you to look at [376] the cancelled check, itself, No. 260, on June 2, 1944, on the Southern Wine and Liquor Company, paid order to the—payable of cash in the amount of $8.20, being the amount noted on the check stub?

A. Yes, sir.

Q. And ask you now to tell, or state who the supplier was who received the $8.20?

A. Well, the only explanation I have is the same condition as was in the French Cafe, would have me make out a check for the supplies that were paid out that day.

Q. Did you go upstairs and ask permission to draw this check to cash, check No. 260 for $8.20 on

(Testimony of Robert R. Webb.)

June 2, 1944, and get permission to draw that check from Mr. Rau?

A. He would tell me to draw a check for supplies, not for every—not that one for every day, for any supplies paid out that would amount to, maybe ice, and little incidentals, that were paid out that day.

I would deduct that from the total receipts and he would see it on his statement.

Q. Then instead of paying the incidentals out of the cash register for ice and few little things like that, you drew a check for that?

A. It was paid cash from the register, but that amount then would be made, a check made out for that amount and deducted from the total.

Q. And please explain the purpose of following that [377] practice of paying the cash out of the cash register, and then drawing the check to cash in that amount of money?

A. The bartender would pay it out in cash. He would give me the tickets for ice, or whatever it was. I would take the vouchers to Mr. Rau every day, also with a tape and the amount of the receipts, what each bartender had taken in, also the ticket, the cash register drew, with the amount that each bartender had taken in. And deduct the $8.20 as supplies.

Q. Yes. Now, how did you determine that you should draw a check for $8.20 for supplies on that day?

A. Well, that was evidently the amount of cash

(Testimony of Robert R. Webb.)

paid out from the bar. We paid for limes, lemons, little odds and ends, ice, every day.

Q. From whom did you get that information?

Mr. Gardner: If the Court please——

The Witness: From the vouchers in the bar.

Mr. Gardner: If the Court please, he has answered that same thing three times by now, and this is just becoming repetition after repetition.

I object to the question at this time, going into the same thing over and over and over again.

The Court: It is repetitious.

Mr. Simpson: To a certain extent perhaps, but not entirely so. This witness testified that he drew checks [378] to the suppliers.

The Court: He didn't say to the suppliers; he said for supplies.

Mr. Simpson: But I asked him also if he drew check to the suppliers for the merchandise that was delivered, and he said, yes. Now, I want to find out whether or not he also took this information to Mr. Rau.

The Court: Proceed.

The Witness: The bartender, the bartender——

The Court: Let the witness complete his answer.

The Witness: The bartender, if he paid out $3 for ice, he would have a voucher in the cash register, what he paid out. Or any other item he paid out.

I would get the vouchers with the cash, take the vouchers up to Mr. Rau with all the other details and if it amounted to $8.20, I would make the check out for $8.20

(Testimony of Robert R. Webb.)

He could check over this book every day, any time. He had it right there in front of him.

The Court: This book was what?

Mr. Simpson: Check stub book, Petitioner's Exhibit for identification 26.

I will offer this into evidence at this time, your Honor, so that there won't be any——

Mr. Gardner: I didn't understand that that had been [379] marked, your Honor.

Mr. Simpson: Yes.

Mr. Gardner: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 26, was received in evidence.)

Mr. Simpson: Now, what I wanted to get to from Mr. Webb, was that you got the permission from Mr. Rau to write these checks, that we are talking about, demonstrated by the check stub for the payment of supplies at the bar.

The Witness: Yes, sir.

Q. (By Mr. Simpson): And he knew that?

A. He saw that every day; yes, sir.

Q. Every day?

A. Every day he was there; yes, sir.

Q. Did you take the vouchers themselves up to him? A. Yes, sir.

Q. There might be half a dozen, a total, that might make the total of $8.20? A. Yes, sir.

Q. He looked them over? A. Yes, sir.

(Testimony of Robert R. Webb.)

Q. And then told you to draw the check to cash?

A. He didn't tell me every day. He told me when we [380] started to do that, and I followed the customary——

Q. He had the tapes in front of him, also?

A. Yes.

Q. And the daily sheets from the French Cafe?

A. Yes, sir.

Q. Now, we established that you took those tapes up to him, the vouchers, and he told you to draw a check for that?

He has daily receipts of the French Cafe, showed those to him, and he made no observation or comment when you made him—that you kept the record in the amount not reported as receipts?

A. No, no observation.

Q. And you followed that same practice in 1943, did you, Mr. Webb? A. Yes, sir.

Q. 1944? A. Yes, sir.

Q. 1945? A. Yes, sir.

Q. And 1946? A. Yes, sir.

Q. And 1947? A. Yes, sir.

Q. And at no time did he make any comment about the [381] record that you had made in the daily sheets, showing the amount falsified?

A. Well, we would discuss business and discuss a lot of things, probably, about what was taken in and everything; yes.

Q. It did not occur to you at all to tell him that that was something he shouldn't do, that he would be in trouble with his Government? A. Yes.

(Testimony of Robert R. Webb.)

Q. Did you feel that you might be in trouble with the Government, aiding and abetting in that?

A. Well, at the time it didn't really occur to me. I didn't think I was responsible for it, but I understand now that I am.

Q. You understand now that you are responsible? A. Yes, sir.

Q. Has any action been taken against you on this? A. No, sir.

Q. In connection with your acts?

A. No, sir.

Q. No, sir.

I have no further questions, your Honor.

Redirect Examination

By Mr. Gardner:

Q. Mr. Webb, referring to Exhibit 20, under date [382] of December 16, 1943, would you refer to that page and state whether or not your handwriting appears at the bottom of that page?

A. That is my handwriting.

Q. And referring now specifically to the figure 4720, could you tell us what that figure represents?

A. It represents supplies.

Q. Supplies? A. Yes, sir.

Q. Is that the amount that you would write a check for, to cash? A. Yes, sir.

Q. That you previously testified to in explaining these transactions; is that correct, sir?

A. That is correct.

(Testimony of Robert R. Webb.)

Q. And I would like to have this marked as Respondent's next in order, please.

The Clerk: Respondent's Exhibit T marked for identification.

(The document above referred to was marked Respondent's Exhibit T for identification.)

Mr. Simpson: May I see that, Mr. Gardner, please?

Mr. Gardner: Yes, excuse me.

Q. (By Mr. Gardner): Mr. Webb, I hand you what has been marked [383] Exhibit T for identification, and ask whether or not you can identify this book? A. Yes, sir.

Q. What is that book, sir?

A. That is the check book of the French Cafe.

Q. Is it the check book, or does it have only the check stubs? A. Check stubs.

Q. For the French Cafe. And for what numbers do you have in there, sir?

A. From No. 3201 to 3397.

Q. And that covers a period, does it not, of approximately December 15 of 1943 to January 6 of 1944; is that correct, sir? A. Yes, sir.

Q. Now, referring to check stub No. 3242, under date of December 17, 1943, would you state whether or not your handwriting appears on that check stub, sir? A. Yes, sir.

Q. And what did you write on that check stub?

A. Wrote cash to cash supplies, $47.20.

Q. Is that the same amount that is shown on

(Testimony of Robert R. Webb.)

Exhibit 20, sir, under date of December 16, 1943, referring to the bottom of the page where you put in your summary of the day's receipts? [384]

A. That is the same amount; yes, sir.

Q. This is the amount that you previously testified to, that you prepared a check to cash and marked it supplies; is that correct, sir?

A. Yes, sir.

Mr. Simpson: If your Honor please, I don't know what the purpose of this questioning is, because I think that our stipulation has covered it, and I think Mr. Gardner is going to go back, practically everything that we agreed to; isn't that so, Mr. Gardner?

Mr. Gardner: That is not my intention, your Honor. I intend to ask one or two instances, and ask if this was the practice throughout the proceeding.

The Court: Proceed.

Mr. Gardner: Now, at this time, I would like to offer in evidence Respondent's Exhibit T.

Mr. Simpson: No objection.

The Court: Admitted.

(The document heretofore marked as Respondent's Exhibit T for identification, was received in evidence.)

Q. (By Mr. Gardner) This is Exhibit T, Mr. Webb, referring to the daily sheets for the year 1944, that are in evidence as Exhibit 21, going to

(Testimony of Robert R. Webb.)

the sheet for January 5, 1944, do you see your handwriting at the bottom of that page, sir? [385]

A. This is all my handwriting, this right-hand side of the page.

The Court: Right-hand side at the bottom?

The Witness: At the bottom.

Q. (By Mr. Gardner): Right-hand side at the bottom? A. Yes, sir.

Q. Now, there is a figure there, sir, in the amount of $62.30, would you state what that figure is, sir? A. That was for supplies.

Q. For supplies. Did you do anything else in connection with that figure, did you write a check in that amount?

A. I wrote a check in the amount of $62.30 and marked it supplies.

Q. Now, referring to Exhibit T, under date of January 6, 1944, check stub No. 3394, does your handwriting appear thereon?

A. That is all my handwriting.

Q. That is all your handwriting. What does that stub say, sir?

A. It says 11/6/1944, cash, supplies, $62.30.

Q. Now, Mr. Webb, in order to save time, would you state now whether or not this same practice continued throughout the year 1944? [386]

A. Yes, sir.

Q. Throughout the year 1945?

A. Yes, sir.

Q. Throughout the year 1946?

A. Not all through the year 1946.

(Testimony of Robert R. Webb.)

Q. Up until what date, sir?

A. Well, up until—I am not sure of the month.

Q. There was a partnership formed in 1946?

A. There was a partnership formed.

Q. Up until that partnership was formed, you did that same series of acts? A. Yes, sir.

Q. Relating to the drawing of check to supplies?

A. Yes, sir.

Q. And recording——

The Court: Check to cash.

Mr. Gardner: Excuse me, check to cash.

The Witness: Yes, sir.

Q. (By Mr. Gardner): And marking it for supplies and recording——

A. Yes, sir.

Q. And recording it on that daily sheet of the French Cafe? A. Yes, sir.

Q. Now, did that continue throughout the year 1943, [387] also, sir? A. Yes, sir.

Q. Throughout the year 1942?

A. Yes, sir.

Q. At least when you started this practice in 1942? A. Yes, sir.

The Court: Now, when you cashed such a check, what did you do with the proceeds of it, that you received?

A. The proceeds were added onto the receipts for the bank. If the receipts were $300 and I wrote a check out for $62.30, I would make it $362.30, to deposit in the bank.

(Testimony of Robert R. Webb.)

The Court: You would add them then to the receipts for the particular day of the French Cafe?

A. Yes, your Honor.

The Court: And they would ultimately find their way into deposits into a bank, into the account for the French Cafe?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Are those deposits shown in Exhibits R, O, N, P, S, and Q?

A. Yes, sir.

Q. Would you examine them, please, sir?

Mr. Simpson: If your Honor please, I thought this had been established already on direct testimony that the [388] receipts were recorded in the year books.

Mr. Gardner: Let the record show that the witness examined——

The Witness: Yes.

Mr. Gardner: Just named and stated that the receipts were recorded in these books, and that in instances in which you wrote out a check to cash, charged it as supplies, that increased the receipts for that day.

The Witness: Yes, sir, that is correct.

Q. (By Mr. Gardner): And the increased amount was shown in the exhibits just named; is that correct, sir? A. Yes, sir.

Mr. Gardner: I have no further questions of this witness, your Honor.

Mr. Simpson: Just one previous question. I think

(Testimony of Robert R. Webb.)

perhaps Mr. Gardner has clarified it, though, and that is this:

Recross-Examination

By Mr. Simpson:

Q. These daily sheets in which the receipts were increased by the various amounts to which you have testified, for instance, 3335 on September 20, was not just for the bank, it also reflected increase in the receipts for that day? A. Yes, sir. [389]

Q. And that that amount was then transposed and recorded in the date books? A. Yes, sir.

Mr. Simpson: Thank you. I have no further questions.

Mr. Gardner: I have no further questions to ask of this witness.

The Court: You may step down.

The Witness: Thank you.

(Witness excused.)

Mr. Gardner: I would like to ask a further favor of this Court. I have no further questions for this witness, and if Mr. Simpson anticipates using him again or does not, I would like this witness to be allowed to be excused.

Mr. Simpson: At this time, your Honor, I see no need to recall the witness, but I would like to reserve the right to do that, if it becomes necessary. At this time, I can't see any occasion for it.

The Court: Do you wish him to be excused?

Mr. Simpson: Yes.

The Court: He may be excused.

Mr. Gardner: Thank you, your Honor.

The Court: We will reconvene at 2:00 o'clock.

(Whereupon, at 12:40 p.m., the hearing in the above-entitled matter was recessed until 2:00 o'clock of the same day.) [390]

Afternoon Session—2:00 P.M.

Mr. Simpson: May it please the Court, Mr. Gardner has gratiously condescended to permit me to put two witnesses on out of turn. With your permission, I call them now. Dr. Seymour Strongin.

SEYMOUR STRONGIN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Would you be seated. State your name and address, sir.

The Witness: Dr. Seymour Strongin, Bakersfield, California.

The Clerk: Would you spell it?

The Witness: S-e-y-m-o-u-r S-t-r-o-n-g-i-n.

The Clerk: Thank you.

Direct Examination

By Mr. Simpson:

Q. Doctor, you have already stated your full name and address. I ask you if you will state what is your profession.

A. I am a doctor of medicine.

(Testimony of Seymour Strongin.)

Q. By that do you mean that you are a general practitioner? A. Yes, sir. [391]

Q. Doctor, have you specialized in any particular branch of medicine?

A. No, sir. I do general practice.

Q. General practice. And for how long a period of time have you practiced your profession?

A. For 30 years in Kern County.

Q. Have you practiced in the town of Bakersfield? A. Some 27 and a half years.

Q. During that time, did you have occasion to treat Mr. Walter F. Rau, Sr., professionally?

A. Yes, sir, I have.

Q. Can you state to the Court when your treatments began?

A. I saw Mr. Rau on at least six occasions; first time, August 24, 1942, and on the last occasion on September 21, 1945.

Q. Now, can you state the nature of the treatment that you prescribed or advised for Mr. Rau?

A. I treated him for a multiplicity of conditions. At the time I first saw him, he had an alcoholic neuritis and arthritis, a thrombophelebitis and myocarditis.

During the course of my seeing him, he also developed myocardio heart failure—that is heart failure—and he also developed a nephritis, Bright's disease.

Q. Excuse me. Go ahead, sir. [392]

A. During the times I saw him, the one thing

(Testimony of Seymour Strongin.)

that more or less was present on all the occasions was a considerable degree of alcoholism.

Q. After, when you saw him, was he under the influence of alcohol?

A. Mr. Rau was under the influence of alcohol on every occasion that I saw him.

Q. Doctor, will you state your professional opinion, the excessive use of alcohol and its effect upon the person's brain, if any?

A. I am convinced that in his condition the use of alcohol caused a good degree of mental deterioration. He was inebriated on all the times I saw him. He was shaky, excited, inability to reason things out, wouldn't follow instructions, forgot from time to time what I told him to do; he wasn't a very cooperative patient, primarily, I think due to the fact that he was drunk most of the time.

Q. Now, would his age be a factor in combination with the excessive use of alcohol as to any general mental habilitation?

A. The older he got, undoubtedly the more age did become a factor, that is his nephritis and his circulatory deterioration in itself, could cause mental deterioration; add onto that the alcoholism and you have a sort of double [393] impact.

Q. Well now, can you state whether or not you observed a gradual decline in his physical health, as well as his mental health?

A. During the three years I saw him, there was definitely a decline in his physical health.

(Testimony of Seymour Strongin.)

Q. Now, let's cover the years that you examined him again. A. '42 to '45.

Q. Doctor, in your professional opinion, was Mr. Rau mentally capable or competent to manage his affairs?

Mr. Gardner: If the Court please, I object to that question on this grounds, while the doctor is well qualified as a medical man, he has stated that he is a general practitioner, there has been no foundation laid that the witness is an expert as to the manners of the mind, mental competency and that sort of thing. And I have an idea that that is the purpose of this question, is to get an opinion of an expert.

I submit to the Court that he is not, has not laid a proper foundation for such a question.

The Court: I will receive it as the opinion of a general practitioner, but not as the opinion of a man who has devoted himself to mental diseases.

Q. (By Mr. Simpson): [394] Doctor, with respect to a man's mental condition, does the excessive use of alcohol have an adverse, injurious effect upon his brain?

A. Definitely, alcohol is a toxic agent. It causes a certain amount of what is chemically regarded as intoxication, and that is more or less demonstrated in a manner of speaking, by an inability to reason and act clearly.

Q. Now, will you state again, sir, whether or not, in your opinion that Mr. Rau, by the use of alcohol

(Testimony of Seymour Strongin.)

to excess at his age would make him subject to the influence or wishes of other persons around him?

A. I have no doubt that it did make him subject to the wishes of others around him.

Mr. Simpson: I have no further questions.

Cross-Examination

By Mr. Gardner:

Q. Dr. Strong——

A. Strongin, Strongin, S-t-r-o-n-g-i-n.

Q. Thank you, sir.

You stated I believe that you saw Mr. Rau during the years of 1942 and 1945; would you state once again how many times you saw him?

A. I saw him at least six times that I have record of. [395]

* * *

Q. Now, as to whether or not he was subject to the will of others, that is strictly conjecture on your part, isn't it, doctor? A. Definitely.

Q. You don't know that of your own knowledge, do you, sir?

A. I can't say that I do; no, sir. [401]

* * *

JOHN J. McCARTHY

called as a witness by and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please, sir.

The Witness: John J. McCarthy. 3130 Union Avenue, Bakersfield, California.

The Clerk: Your last name is spelled M-c-C-a-r-t-h-y?

The Witness: Yes, sir.

Direct Examination

By Mr. Simpson:

Q. You have already stated your full name and address, doctor. Now, I would like to ask you, are you a doctor of medicine? A. Yes, sir.

Q. Are you a general practitioner?

A. Yes, sir.

Q. And for how many years have you been a doctor of medicine? A. Since 1934.

Q. And for how many of those years have you practiced in your profession in Bakersfield; before you answer that, where have you practiced your profession?

A. The past, since 1937, past 21 years, in Bakersfield, since 1937; and then of course, I had my internship before that. [405]

Q. You practiced for approximately 27 years in Bakersfield? A. No.

Q. Have you specialized in any——

(Testimony of John J. McCarthy.)

A. Beg your pardon. '37, that will be 21 years.

Q. Yes. Have you specialized in any particular branch of your profession? A. No.

Mr. Gardner: I didn't get that. Excuse me.

The Witness: No.

Mr. Gardner: Thank you.

Q. (By Mr. Simpson): During the time that you were practicing your profession in Bakersfield, did there come an occasion when you were called upon to treat Mr. Walter F. Rau, Sr.?

A. Yes.

Q. Do you have any records, or do you recall when you were first called upon to treat Mr. Rau?

A. My recollecting back to first treating him in 1946; my records show from July of 1947 until the time he expired.

Q. The records of July, 1947, until he died, the recollection is that you began your treatments however one year prior to that?

A. At least six months, over six months, I know it was before Christmas, so, nearly a year, yes. [406]

Q. Nearly a year, 1946. Can you now state either from your records, or based on your recollection the number of times that you treated Mr. Rau professionally?

A. Professionally I would sometimes see him every day; as the years went on, of course, I saw him more often. At first, I might see him, saw him about every day for several weeks, and then at least once or twice a month.

Q. Thereafter?

(Testimony of John J. McCarthy.)

A. And then often daily or twice daily, different spaces of his illness.

Q. Do you remember, do your records show or can you recall the nature of Mr. Rau's illness and what you prescribed for him?

A. Well, in 1946, the reason I was called to the hotel to see him was because of a marked phlebitis of the lower legs. That is inflammation and clotting in the veins.

At that time he was also known to have—he had a high blood pressure, hypertension, and some congestive heart failure, and chronic nephritis, and marked arteriosclerosis.

Q. Did you treat him, did you treat him at his home? Where was he residing when you treated him?

A. When I first treated him, he was residing in the hotel. My records go back to the time I saw him in the home. I don't know if I have my records while he was in the hotel. [407]

Q. Is that the Southern Hotel?

A. Yes, sir.

Q. Now, when you saw him at the Southern Hotel, you were called in to treat him, did you observe whether or not he was under the influence of alcohol?

A. I have been in to see him in the morning, in the middle of the night, and in the afternoon, I don't believe there is any time in those first few years that he wasn't at least somewhat under the influence of alcohol.

(Testimony of John J. McCarthy.)

Q. Have you examined the records, not only of your own, but from any other source, which would advise you of the condition that Mr. Rau had prior to the time that you actually began your treatment of him?

A. Well, I hospitalized him at Mercy Hospital in Bakersfield in December of 1947, because of a stroke.

Q. Because of a stroke? A. A stroke.

Q. A stroke.

The Court: Was that the first time you had hospitalized him?

The Witness: Yes, it was. Wait a minute, let me make sure of that, sir.

Yes, that is the first time I hospitalized him. At that time, of course, I had reason to look back on these [408] records, and to see about past history, and I ran across some very—he was treated by Dr. Goodall.

Mr. Gardner: If the Court please, I object to relating to treatment by anyone other than Dr. McCarthy.

Mr. Simpson: If your Honor please, I think this witness will testify that he examined the records of a public institution for the purpose of determining any medical history of his patient, past history.

I think he is certainly qualified to testify with respect to what he found in the hospital records.

Mr. Gardner: I object to this on the ground that that is hearsay, there is nothing to establish these records as being accurate, no way we know of that—

(Testimony of John J. McCarthy.)

how they are kept, just how the entries were made in them.

I object to any testimony relating to these records whatsoever.

The Court: I presume that hospital records would be admissible in evidence if properly, if the foundation is properly laid for them. The testimony here, the evidence now being presented here, goes one step beyond that. It undertakes to describe the contents of those records by secondary means.

Mr. Simpson: If your Honor please, I think——

The Court: The—are the records in court?

Mr. Simpson: No. I have asked him if he had a [409] record or examined any record of past history of this man. Now, he can certainly answer that.

Now, if I ask him in connection with that past history did it confirm his own examination of this man, now, he would be able to testify to that, certainly.

The Court: I would receive such records, themselves, in evidence, if there was proper foundation laid for them, but I don't know what kind of records this witness looked at. For all I know, he might have looked at the right kind of records, or he might have looked at the wrong kind of records, as far as admissibility is concerned.

Mr. Simpson: Then let me attempt to develop what the records were and then with leave of Court——

The Court: Then you are faced with the prob-

(Testimony of John J. McCarthy.)

lem as to whether or not you have complied with the best evidence rule of bringing them in.

Mr. Simpson: Well then, if your Honor please, I request that the records be kept open until we are able to obtain these records.

The Court: This request is denied. You are supposed to prepare your case and present admissible evidence.

Mr. Simpson: That is true. I learned today for the first time, of course, that there were some other records available at an earlier date, that were maintained in a public institution. So, I have not been able to find that out [410] until today.

The Court: If you obtain them during the course of the trial, I will let you present them at any time during the course of the trial. The record will not be kept open.

It is up to you to prepare your case and present admissible evidence.

Proceed.

Q. (By Mr. Simpson): Doctor, prior to the time that you treated Mr. Rau, professionally, did you have occasion, or were there any occasions on which you saw him under the influence of alcohol?

A. Well, I came to Bakersfield in 1937, and my office was directly across the street from the Southern Hotel. I became acquainted with Mr. Rau at that time, and his family. And had not observed him professionally, but just in a friendly manner. I found contact with him quite often, and saw him almost daily the first few years there.

(Testimony of John J. McCarthy.)

Q. During those times, did you observe him under the influence of alcohol?

A. I would say that most of the time, that as near as I could determine from his gait and speech, that he had been drinking.

Q. Now, subsequent to the time that you began to treat Mr. Rau, did you observe a gradual decline in his [411] mental condition?

A. From the time I first started treating him, there was a definite decline, particularly from the time that this stroke I was telling you about, that he had December of 1947, but there had been even before that time, he had been, in making calls on him in the room or the hotel, I was talking to him, he would often break out crying, and we couldn't get very far with him on many of these occasions.

I have known, too, about that time that he was, when he started water, unable to control his urine, and stools, and I have seen him, the nurse cleaning up the bed after him, acting nurse.

The Court: Could you fix the—as near as you can, the month and the year in which this latter began?

The Witness: Well, it was prior to '46. I don't know as I could state it any closer than that.

The Court: I thought you hadn't seem him professionally before '46?

A. I hadn't professionally.

The Court: How would you know about his incontinence?

The Witness: Oh, the incontinent?

(Testimony of John J. McCarthy.)

The Court: Yes.

The Witness: That started in the latter part of '46, and was more marked in '47, until later he wasn't able to control them at all. I didn't know about that. I [412] thought you meant the mental degeneration.

The Court: At what point did his inability to control his natural functions commence?

The Witness: Well, sometimes this wasn't just an inability, it was perverseness and his way of, I think, getting back at the nurse a lot of times.

The Court: I didn't hear your answer clearly.

The Witness: I think at times that this was purely perverseness on his part that to—about the only way he could get back at the nurse, for anything he suspected, anything that he didn't like the way she might have done to him.

Q. (By Mr. Simpson): Doctor, with respect to Mr. Rau's physical condition, can you state if he was required, in order to move around, did he use a wheelchair? A. When, did you say?

Q. Yes. A. Of if he was; yes.

Q. Can you state the year in which he was required to use a wheelchair?

A. Well, I know he was in '47. I am not sure about '46, whether he had one in the hotel or not. I am quite sure he did, but I wouldn't swear to that. I know he had one from the time he moved out to his home. [413]

Q. Do you know whether his room was on the first floor of the hotel or second floor?

(Testimony of John J. McCarthy.)

A. It was second or third. I think it was second.

Q. Did he use an elevator? A. Yes.

Q. Go to downstairs? A. Yes.

Q. Doctor, in your opinion, do you think that Mr. Rau was competent to manage his affairs after you began your treatment in 1946?

Mr. Gardner: If the Court please, I would like to make the same objection to the testimony of this witness that I made to the testimony of the prior witness, that is Dr. Strongin, on the grounds that, as I understand it, this is a question calling for an opinion by an expert, and we have had no foundation laid as to this witness being an expert of the mind.

The Court: I will receive his opinion with full awareness, however, that he has not been qualified as an expert on mental diseases, but with the knowledge, however, that his opinion is probably worth more than that of an average layman.

Mr. Simpson: I have no further questions.

The Court: The witness may answer.

Mr. Simpson: Oh, yes, I am sorry. [414]

Q. (By Mr. Simpson): You may answer that question, doctor, almost forgot that.

A. Well, it is my opinion, due to the hypertension, the arteriosclerosis, the senility—he was 73 years of age when he had that stroke—in my physical examination at the hospital, at that time, which I didn't get a chance to——

Mr. Gardner: Excuse me, are you referring to one of those records?

(Testimony of John J. McCarthy.)

The Witness: No, this is my own.

Mr. Gardner: Excuse me.

The Witness: My own record of the first hospital call, he had an arcus senilus around each pupil, which is a physical indication of marked arteriosclerosis, probably beyond his years, and with the alcoholic history over a long period of time, I am sure that during the time I saw him, and he progressively got worse, that he was not able to rationally take care of his business.

Mr. Simpson: Thank you, I have no further questions.

Cross-Examination

By Mr. Gardner:

Q. Now, what was the——

The Court: Was he in your judgment, was he sufficiently rational however, that you would have felt justified in [415] cashing a check that he might have given you for your fee?

The Witness: Well, I believe so, as long as the bank would honor it. But I seldom did. I don't believe I ever did receive a check from him, unless it was sent to the office.

The Court: Would you have felt justified in taking your fee in cash from him?

The Witness: I did. The reason I got it from the desk, or I think I have got it from him, too, or from his nurse. I think during those first years that I would have, I am not sure that I did. I don't see that it was unethical.

(Testimony of John J. McCarthy.)

The Court: I put the question to you, not as an ethical question, but simply to test your judgement as to how competent or incompetent you thought he was. And I ask you whether you think he was so incompetent that you would not have felt justified in taking, in cashing a check if he had given you one?

The Witness: I think I would have accepted it the first year or two.

The Court: That is in 1946 and '47?

The Witness: Yes, sir.

Q. (By Mr. Gardner): It was your statement that you would accept the check, doctor?

A. Yes, sir. [416]

Q. In those years, 1946 and 1947?

A. Yes, sir.

Q. I believe you had testified that in, sometime in 1946 apparently, Mr. Rau apparently lost control of his natural functions; is that true, doctor?

A. Yes. I did state that. I am not so sure that he lost, in viewing the testimony, I am not so sure that he lost control of them at that time, that he did do his natural functions in bed. How well he got in trouble, I don't know.

Q. You don't know? A. No, sir.

Q. In fact, you rather suspect that he was antagonistic or had some grievance against the nurse; isn't that what you testified? A. Oh, sure.

Q. Would you say that Mr. Rau was a rather strong-willed man, sir?

(Testimony of John J. McCarthy.)

A. Depends on what you mean by strong-willed. If you mean determined——

Q. Yes.

A. I would say he was a determined man.

Q. A very determined man. And he exhibited this determination during this period, 1946 and 1947, did he not, sir? [417] A. Yes, he did.

Q. I believe you testified that you first knew him around 1937; is that correct, doctor?

A. Yes, sir.

Q. And your office is just across the street from the hotel, wasn't it? A. Yes, sir.

Q. Consequently, I imagine—did you dine at the hotel? A. Yes, sir.

Q. Did you ever visit the bar at the hotel?

A. Yes.

Q. Did you ever have any drinks with Mr. Rau?

A. Yes.

Q. Did you consider him good company?

A. No.

Q. You didn't consider him good company. Did he talk too much? A. No. He wasn't——

Mr. Simpson: If your Honor please, I think this goes way beyond the scope of the direct examination. It is opening up something that is not even pertinent to this, whether or not Mr. Rau was good company or anything else; way beyond the scope of the direct examination.

Mr. Gardner: If the Court please, there has been [418] testimony here that, indicating that Mr. Rau was drunk all the time, or at least, on the occa-

(Testimony of John J. McCarthy.)

sions when the doctor would see him. I would like to find out just what the doctor considers as being drunk. I would like to find out just what being under the influence of liquor is. I don't really know.

The Court: Proceed.

Mr. Gardner: Would you read the question, please?

(Record read.)

The Witness: He wasn't a loquacious man.

Q. (By Mr. Gardner): He wasn't a loquacious man? A. No.

Q. How many drinks would you have with him when you would see him in the bar, say in 1942?

Mr. Simpson: Object, your Honor. I don't see how that has any relevancy to this issue here, as to how many drinks this witness had, and that is definitely beyond the scope of direct examination.

The Court: The number of drinks that this witness had is of no relevance, the number of drinks that he observed Mr. Rau take might well be relevant.

Mr. Gardner: I would also like to see just how many drinks the doctor had at the same time, so that I can compare his testimony as to whether or not he may or may [419] not have been under the influence of liquor, also.

Mr. Simpson: If your Honor please, this is a professional man, expert, called to testify with respect to a deceased, and counsel for Respondent is now inquiring into this man's drinking, as to how much he can drink in order to make a comparison.

(Testimony of John J. McCarthy.)

Certainly, it is not only irrelevant, incompetent, goes beyond the scope of direct examination. I can't see how it is admissible at all.

Mr. Gardner: I mean no insult to the doctor, your Honor. I merely want to determine just how he knows, how he knew that the deceased Mr. Rau was drunk.

The Court: I am satisfied as to the good faith of Government counsel, and I think it may have some relevance. This being cross-examination, I will permit him to continue.

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): Now, you understand, doctor, I am not trying to probe into your private life at all. A. Yes.

Q. I am trying to find out the number of occasions that you did drink with Mr. Rau and how many drinks would you have with him, sir?

A. You asked that question and I answered I had a drink with him, but I probably wasn't there once or twice [420] all the time I knew him. Most of his drinking was done in the room.

Q. Did you observe him drinking in the room?

A. Yes, sir.

Q. What were you doing on those occasions?

A. Attending him professionally.

Q. You did not attend him professionally, I believe you stated prior to 1946?

A. That is right.

Q. Now, in 1942, I understood your testimony to be that you observed him at least under the influ-

(Testimony of John J. McCarthy.)

ence of liquor in '42, '3, '4 and '5; is that correct, sir? A. That is right.

Q. And I asked you whether or not you had occasion to go into the Southern Bar?

A. That is right.

Q. Did you, sir? A. Yes, sir.

Q. During 1942, '3, '4, and '5?

A. Yes, sir.

Q. Did you see Mr. Rau in the bar at any time, sir, during those—— A. Yes.

Q. ——years? A. Yes. [421]

Q. Did you have any drinks? A. No.

Q. You had no drinks with him? Would you speak to him, sir? A. Yes.

Q. Where would he be sitting?

A. I don't know as I ever saw him sit down. Oh, yes, I saw him sit in the lobby, but I never saw him sitting around the bar.

Q. What would he be doing in the bar, sir?

A. He just amble in and amble out.

Q. Amble in and amble out? A. Yes.

Q. Was he having any trouble walking at that time, sir? A. Yes.

Q. And how would he get along, with a cane?

A. Some, he used a cane, yes.

Q. He used a cane, he had trouble with his legs, didn't he, doctor? A. Yes.

Q. If he were sober, would you say he would have difficulty walking with this cane?

A. Yes.

Q. If he was under the influence of alcohol,

(Testimony of John J. McCarthy.)

would it [422] be possible for him to maneuver at all, doctor, during 1942, '3, '4, and '5?

A. Yes.

Q. You think he could maneuver, it would be extremely difficult, though, wouldn't it, doctor?

A. Well, he had what we call a shuffling gait, and I think, shuffling gait, I think that that probably wouldn't change much as to whether he was drinking or not.

Q. Is it your testimony, sir, that this man could be drunk and get along better than an ordinary person who didn't need a cane, could walk better than an ordinary person, sir?

A. No. I meant that he could, he would, his gait was such that you couldn't tell, perhaps, whether he has been drinking or from his natural shuffle.

Q. I see. So that many of the times that you saw him it could be the result of this natural shuffle that you assumed he had been drinking; is that correct, doctor?

A. Well, I knew him pretty well, I think; even a layman could tell that he had been drinking. Actually, in the room, I was where I saw most of the drinking.

Q. We are referring to the number of times you saw him shuffling into the bar in the years 1942, '3, '4, and '5, and I suppose he did this in 1946, too?

A. He got pretty, well, feeble that the—at that time [423] I did, he did some.

Q. You don't remember whether or not he had a wheelchair at that time, do you, doctor?

(Testimony of John J. McCarthy.)

A. I don't remember for sure.

Q. So, if he didn't have a wheelchair——

A. He must have had a wheelchair to get around, to get down, but I couldn't swear to that.

Q. You wouldn't swear to that in 1946, would you, doctor? A. No.

Q. So that at this time, in order for him to get around now, here is a man who has trouble with his legs; doesn't he, doctor? A. Yes, sir.

Q. And if he is inebriated or drunk, this man would have a great deal of difficulty walking, wouldn't he, doctor?

A. Well, with that gait, I believe it would be hard to tell a shuffling gait that is one that you are protecting yourself, anyhow.

Q. Well, could you tell me this, doctor: does intoxication, that is from drinking liquor, alcoholic beverages, does that affect the balance?

A. Yes, sir.

Q. It does, doesn't it, doctor?

A. Yes, sir. [424]

Q. Now, is it your testimony that the balance in Mr. Rau's mind is not affected as much as a person who was not affected with these diseases that he had?

A. Well, I would like to have you repeat that, please.

Q. Maybe I don't understand it, myself.

Will the Reporter read it, please?

(Question read.)

(Testimony of John J. McCarthy.)

The Witness: It is a little ambiguous, but I would state that the diseases wouldn't make him any less affected by alcohol; does that answer your question?

Q. (By Mr. Gardner): The disease would not make him any less affected, is that what you say, sir? A. That is right.

Q. Now, if he had difficulty keeping his balance when he is sober, he would have greater difficulty keeping his balance when he was intoxicated?

A. That is right.

Q. And it would be much greater than a person who was not ill or not sick; is that correct, sir?

A. Yes, sir, but may I interject something here?

Q. Surely.

A. You are talking about a drunk man all the time. I am talking about an alcoholic. [425]

Q. Well, very good, doctor. Would you explain the difference here?

A. Well, as far as we are concerned, the difference is a matter of acuteness. Acute being you might say, is one type of—is being drunk or you can be drunk all the time, but at least in an alcoholic state, and you don't have to be drunk all that time. If you are drinking, it affects the mind, we feel, along with these other conditions.

Q. Now, does it also affect the balance?

A. I believe it would over a long period of time.

Q. It would, wouldn't it, doctor? A. Yes.

Q. Certainly it would. And if a man was, had these infirmities that you specify, requiring him to

(Testimony of John J. McCarthy.)

use a wheelchair in 1947, if he drank at all, or became intoxicated, surely couldn't shuffle around, could he, doctor?

A. In '47 he couldn't shuffle around.

Q. But at least he was shuffling around in 1942, '3, '4, '5, and '6, wasn't he, doctor?

A. Yes; yes, sir.

The Court: Now, were the infirmities which required him to use a wheelchair infirmities that were related to alcoholism or were they other types of infirmities?

The Witness: Well, the alcoholism would have been one [426] of the causes. The arterio——

The Court: What do you regard as the principal cause?

The Witness: Well, the arteriosclerosis, whatever its cause might be, and alcohol is one that causes that. Senility is another cause, or any toxic poisoning and somebody who just developed arteriosclerosis by heredity.

Mr. Gardner: Might I clear that up?

Q. (By Mr. Gardner): I believe you testified, doctor, that in 1946 he had phlebitis; is that correct, sir? A. Yes, sir.

Q. Would you explain what that is, sir?

A. Phlebitis is an inflammation of veins. The word means, literally—but he gets clots in the veins, lower legs, those varicose veins, and they become infected.

Q. Actually this was the reason that Mr. Rau had difficulty walking, wasn't it A. Yes, sir.

(Testimony of John J. McCarthy.)

Q. That is what we are talking about?

A. Yes.

Q. That is the reason he had to use a cane?

A. At first, yes.

Q. And you treated him for that for the first time in 1946; is that correct, sir?

A. Yes. [427]

Q. So that he got along all right in 1946, on up into 1947 and sometime in 1947 started using a wheelchair; isn't that correct, doctor?

A. That is right. He may have in '46, but I am not sure.

Q. Now, he had this phlebitis, this trouble prior to '46, didn't he? A. Not to my knowledge.

Q. Did he walk with a cane prior to 1946?

A. He used a cane occasionally.

Q. He used a cane, the reason that he used a cane was because he had trouble with his leg, isn't that right, doctor?

A. I don't know; I wasn't his physician.

Q. When you examined him in 1946, could you tell me now whether or not this looked like a chronic condition, or was this something absolutely new?

A. The phlebitis was an acute flareup, but the arteriosclerosis, that was an old thing.

Q. That was the reason he walked around with a cane, wasn't it, doctor? A. Yes.

Q. That was shown by your examination, too, wasn't it? A. Yes, sir. [428]

Q. Now then, let me ask you this: doctor, did you have any financial transactions with Mr. Rau,

(Testimony of John J. McCarthy.)

other than for your fee? A. No, sir.

Q. Did you ever observe him in talking or discussing financial matters with others?

A. No, sir.

Q. When you would see him in the hotel, did you observe whether or not he would go around to the desk, or go around to the cash register, or anything like that?

A. I never noticed that he did. He just kind of seemed to be wandering around, looking around. I didn't see him taking any particular interest in the business.

Q. But he was there all the time, wasn't he, doctor? A. That I don't know.

The Court: Fix the time of your inquiry.

Mr. Gardner: Yes.

Q. (By Mr. Gardner): Referring specifically to the years 1942, 1943, 1944, 1945, 1946 and 1947, that is up to that time in 1947 that he moved out of the hotel, at the time——

A. At the time I took care of him in '46, late '46, I don't believe he ever got out of the hotel except going for a car ride or something like [429] that.

Q. He was right there in the hotel, wasn't he?

A. They would get him out to the car, some way, and take him for a car ride. He still had a wheelchair.

Q. It was in 1947, I believe you testified, doctor, that he had the cerebral accident; is that correct, sir? A. Yes.

(Testimony of John J. McCarthy.)

Q. Some sort of accident, a stroke?

A. Yes.

Q. Up until that time he maneuvered around, didn't he, doctor? A. Yes, sir.

Q. And he was on the scene, at least you can testify to that, can't you, doctor? A. Yes, sir.

Q. Now, you have stated that you had no financial transactions with him, haven't you, sir?

A. That is right; yes, sir.

Q. Did you have any discussions with him regarding your fee? A. No, sir.

Q. With whom did you discuss the fee, sir?

A. Usually in the hotel he just—"Pick up at the desk on your way out."

Q. He knew what he was doing, didn't he, doctor? A. He knew that much all right. [430]

Q. During the time that you had your office across the street, doctor, in '42, '43, '44, '45, did you ever observe Mr. Rau go to the bank?

A. No, sir.

Q. You never did. It wouldn't be your function, anyway, to sit there and look out the window.

A. No. In case I happened to be looking out——

Q. The only time you would see him was when you would go to the hotel?

A. I have seen him from the window in his earlier years, but just be in the doorway or something.

Q. You don't know where he was going?

A. No.

(Testimony of John J. McCarthy.)

Mr. Gardner: I believe I have no further questions.

Mr. Simpson: If your Honor please.

Redirect Examination

By Mr. Simpson:

Q. Doctor, you have been asked some questions with respect to the activity that you observed on the part of Mr. Rau in his hotel, the management, knew what was going, as counsel has stated.

Do you know Mr. Robert Webb?

A. I have met him, yes.

Q. Do you know what his position was with Mr. Rau?

A. I understood that he was clerk or he was, acted [431] as clerk.

Q. Did you see him at the hotel on the occasions that you came into the hotel? A. Yes.

Q. What was he doing?

A. I usually saw him behind the desk.

Q. Was he running the business, doctor?

A. It appeared that way, but I don't know. I didn't inquire to that.

Q. Do you know Miss Rose Goldstein?

A. Yes.

Q. Did you also see her there at the hotel?

A. Yes.

Q. Do you know in what capacity she was employed by Mr. Rau?

A. I don't—I didn't know that she was em-

(Testimony of John J. McCarthy.)

ployed at all. At the time she had a desk there and did some public stenographic work, as I understood. And that is about as well as I knew her. I didn't know her real well.

Q. But you saw her around the hotel on the occasions that you also saw Mr. Webb?

A. That is right.

Q. And was it your impression by watching Mr. Webb, particularly that he was the one that was operating this business that you saw at the [432] hotel?

Mr. Gardner: If the Court please, I believe this is not proper redirect examination. I didn't ask any questions about Mr. Webb or Miss Goldstein.

Mr. Simpson: You asked questions as to whether or not Mr. Rau was going around and looking at the business.

The Court: The question is, subject matter is appropriate enough, I think. But the witness has already been asked that by Mr. Simpson, and as I recall his answer, he said he couldn't swear to it, as to whether Mr. Webb was running the hotel.

You have rephrased the question. Now you have stated the same question in somewhat different words. I think in substance it is the same one that he previously said he couldn't answer.

Mr. Simpson: What I am trying to develop now is whether or not it was his understanding or impression, by watching Mr. Rau, as Mr. Gardner has developed from him, as to whether Mr. Rau was

(Testimony of John J. McCarthy.)

actually running the business, or it was someone else.

The Court: Perhaps I misheard the question. Will the Reporter please read it.

(Question read.)

The Court: I am confirmed in my recollection of the question that it relates to Mr. Webb, and my impression is that the witness had previously stated that he couldn't swear [433] to whether or not Mr. Webb was running the business. I regard this as repetitious in another form of the same question that the witness had previously said he could not answer.

However, I will let you put it to him and let the witness endeavor to answer it.

Mr. Simpson: Before we do that, your Honor, you may be correct in your recollection. I do not recall his answer to be that he couldn't swear that Mr. Webb was running the business.

The Court: That is my recollection of what he said. The record, the transcript will speak for itself here. Nevertheless, I will permit the witness to give his answer to the question at this time.

You may answer that, doctor.

Mr. Simpson: I will withdraw the question; I will not ask the question.

Q. (By Mr. Simpson): Doctor, on the occasions that you came to the hotel, did you see Mr. Webb there on each of those occasions?

A. Not always.

(Testimony of John J. McCarthy.)

Q. When you did see him, what was Mr. Webb doing? A. Almost always behind the desk.

Q. Did you see Mr. Webb at the bar?

A. I don't recall. [434]

Q. At the bar?

A. I don't recall it. I believe that there was a little room back of the desk—I am not too sure—that he used to be in there with some papers. That is as far as I could swear.

Q. The occasions that you were called to treat Mr. Rau, were you called by Mr. Rau or by someone else, do you know?

A. I was invariably called by someone else.

Q. By someone else. Now, the fee that you charged Mr. Rau was no more than you would charge for any other visit for anyone else?

A. No, sir.

Mr. Simpson: I have no further questions.

Mr. Gardner: I have no further questions, your Honor.

The Court: There will be a short recess.

(Short recess.)

Mr. Gardner: Call Miss Rose Goldstein, please.

ROSE GOLDSTEIN

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: My business name is Rose Goldstein; also known as Rose Longway, my married name. 210 Brink [435] Drive, Bakersfield, California.

Direct Examination

By Mr. Gardner:

Q. Miss Goldstein, are you married?

A. Yes, sir.

Q. What is your married name, please?

A. Rose Longway.

Q. Longway? A. Yes, sir.

Q. Do you go under the business name of Rose Goldstein, do you not? A. Yes, sir.

Q. For the purpose of this record, I will refer to you, with your permission, as Miss Goldstein; is that all right? A. Yes, sir, that is okay.

Q. Miss Goldstein, what is your present occupation?

A. Public stenographer, Notary Public, income tax service, telephone, mailer.

Q. And where is your office at the present time?

A. Well, since the last two years I have been doing some of my work at home, that I have been hurt. I had to give up my office.

Q. So now you maintain your office in your home; is that correct? [436] A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. What is the nature of your infirmity, Miss Goldstein?

A. Well, I fell down an elevator and broke both my legs. That will be two years the 22nd of next month.

Q. Now, referring to the, a period prior to this, back in the early '30's, would you state whether or not you knew Walter F. Rau, Sr.?

A. I think I met him approximately about 1935. I am not——

Q. 1935? A. Yes, sir.

Q. What was the occasion of this meeting, Miss Goldstein?

A. Well, I would go in there to eat, you know, in the hotel there. I knew some people and then I went in there about—he wanted me to type the menus for the French Cafe.

Q. Well, how did you become engaged to type the menus for the French Cafe?

A. Fred Seal, one of the guests who was staying there was talking to Mr. Rau and he came and asked me to go see Mr. Rau and Mr. Rau called me and I made an appointment with him.

Q. This was as near as you could place it in the [437] year 1935; is that right?

A. Approximately; yes, sir.

Q. Would you state whether or not you subsequently moved your office to the lobby of the Southern Hotel? A. I did later on.

Q. How much later on? A. Well——

Q. 1935, 1936, about two months later?

(Testimony of Rose Goldstein.)

A. Well, from two months to six months later.

Q. You moved your offices and this was in 1935 then?

A. Well, approximately that time.

Q. Approximately. What sort of accommodations did you have in the Southern Hotel, Miss Goldstein?

A. Mr. Rau, Walter F. Rau, Sr., says I could have my desk space there for typing the menus and one meal a day.

Q. And where was your desk space?

A. It was in the hotel lobby.

Q. In the hotel lobby?

A. 1907 Chester Avenue.

Q. Did you subsequently do any other work for Mr. Rau?

A. Well, one time Mr. Webb came to me and asked if I knew of a bookkeeper. I said, well, what about myself. [438] and then Mr. Webb came back, I don't know whether that same day or the next, and he said Mr. Rau said you could take care of it.

I asked him how much he would pay me. He said $10 a month.

Q. $10 a month? A. Yes, sir.

Q. Just what businesses or business did you keep the records for; were you employed to keep the records for?

A. The Southern Hotel, and when they opened up the French Cafe, and then after prohibition, the Southern Wine and Liquor.

Q. In other words, I believe you stated that you

(Testimony of Rose Goldstein.)

were employed in 1935; could it be that you were employed prior to 1935?

A. Well, I can't recall.

Q. In any event, you do know that you took care of the records of the Southern Wine and Liquor and the French Cafe, and the Southern Hotel?

A. Yes, sir, and others for Mr. Rau.

Q. And others for Mr. Rau? A. Yes, sir.

Q. But relating to those three?

A. Yes. [439]

Q. That is once again the Southern Hotel, the French Cafe, and the Southern Wine and Liquor?

A. Yes, sir.

Q. Would you state whether or not you were keeping those records in 1935?

A. Well, approximate to my, to the best of my knowledge.

Q. Were you keeping them in 1936?

A. Up until the time the hotel was demolished.

Q. You kept them all through those years?

A. But not for the French Cafe after June 6, when they went into partnership. I didn't take care of that.

Q. June 6 of 1946?

A. To when Mr. Bender and Mr. Rau went into partnership.

Q. I see. That was in 1946? A. Yes, sir.

Q. I see. Now, did you also prepare the income tax returns for Mr. Rau? A. I did.

Q. Did you prepare the income tax returns for the years 1942 to 1946? A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. I show you Exhibit 2D, the income tax return of Walter F. Rau, Sr., and Mary Agnes Rau, for the year 1942, [440] and ask whether or not you prepared that income tax return or those income tax returns? A. Yes, sir.

Q. I show you the income tax return for the year 1943 for Walter F. Rau, Sr., Exhibit 3E, and ask whether or not that is your signature on the bottom of the face of the return?

A. That is——

Q. Did you prepare that return?

A. Yes, sir.

Mr. Simpson: If your Honor please, I stipulate that she prepared the returns for all the years he has. It won't be necessary to go through all that.

Mr. Gardner: Very well. It is stipulated that Miss Goldstein, Rose Goldstein prepared the income tax returns of Walter F. Rau, Sr., for the years 1942, 1943, 1944, 1945, and 1946, and that she also prepared these separate income tax return of Mary Agnes Rau, for the year 1942.

Mr. Simpson: Stipulated.

Q. (By Mr. Gardner): Now, Miss Goldstein, in preparing the income tax returns for each of these years as indicated, what books and records did you use to prepare the returns?

A. You mean where I got the information?

Q. Yes. [441]

A. Or—well, I would get it from the check book when I would write in my cash journal, and then

(Testimony of Rose Goldstein.)

for the cash sheets of the Southern Hotel showing the room rents.

Mr. Simpson: Sorry, your Honor, I didn't hear the second. She used the check books and what was the second?

The Court: The Reporter will read it to you.

(Record read.)

The Witness: And other incomes.

Q. (By Mr. Gardner): Other what?

A. Other incomes.

Q. Mr. Rau had more business in these years than just the Southern Hotel, the Southern Wine and Liquor, and the French Cafe, did he not?

A. Yes, sir.

Q. Now, I am going to direct my questioning to the French Cafe, and I hand you what has been marked as Respondent's Exhibit R, which states it is a year book for the year 1942, and ask if you know what that book is?

A. Well, these would be the amounts that would be taken off of those cash sheets.

Mr. Simpson: Objection, your Honor. I don't think there is any foundation laid that this witness can testify that she made those entries in those books, or what they constitute; asking for a conclusion of what is in that record. [442]

The Court: Will you rephrase your question, Mr. Gardner?

Mr. Gardner: I asked my question I believe, if the Court please, was whether or not she could identify this book, if she knew what it was, your Honor.

(Testimony of Rose Goldstein.)

The Witness: Yes, sir.

Q. (By Mr. Gardner): Would you state what that book is, Miss Goldstein?

A. That is where I would get my records for the receipts of the French Cafe.

Mr. Simpson: It is not responsive to the question.

Mr. Gardner: I think it is, your Honor. This is the book where she would get the records of the receipts. Now, we will trace that from her to her other records.

The Court: The answer will stand.

Q. (By Mr. Gardner): Now, for the year 1942, you were referring to Respondent's Exhibit R; is that correct? A. Yes, sir.

Q. Now, the year 1943, Exhibit O, would you examine that book and state if you know what it is?

A. The same as—get my receipts for the French Cafe.

Q. Would you also get your receipts for the Southern Bar out of that, too, Miss Goldstein?

A. Yes, sir. [443]

Q. Thank you.

The Court: Would that be true also for the other book, 19——

The Witness: Yes, sir.

The Court: 1942?

The Witness: Yes, sir.

Mr. Simpson: I will stipulate that the same procedure followed throughout the rest of the years.

(Testimony of Rose Goldstein.)

Q. (By Mr. Gardner): Did you follow the same procedure throughout the years 1944, '45 and 1946? A. Yes, sir.

Q. Of getting the receipts for the French Cafe from these year books set up as Exhibit N, Exhibit P, Exhibit Q, and Exhibit S? A. Yes, sir.

Q. Now, Miss Goldstein, there is just one other thing——

Your Honor, at this point, the year book for the year 1944 shows in gold "Year book 1938," and the dates throughout this book show 1938, printed dates. Counsel has stipulated that this book, Exhibit N, relates to the year 1944 and shows the daily receipts of the French Cafe and Southern Bar for that year

Mr. Simpson: So stipulated. [444]

Q. (By Mr. Gardner): Now, Miss Goldstein, you have stated that these year books contained the receipts from the business known as the French Cafe, and the Southern Wine and Liquor; is that correct? A. To my knowledge.

Q. At least, these are the receipts that you used and recorded; is that correct? A. Yes, sir.

Q. I will show you Exhibit M, referring now to S-8 of Exhibit M, dated September 25, 1943, and ask whether or not you recognize that sheet?

A. Yes, sir.

Q. What is that sheet, Miss Goldstein?

A. That is the daily cash sheet from the French Cafe and all cash purchases made.

(Testimony of Rose Goldstein.)

Q. Now, does that show on there, Miss Goldstein, the purchases relating to the French Cafe?

A. Yes, sir.

Q. Where would that be shown there, Miss Goldstein?

A. Well, it would be on the left hand, it would be the purchase and miscellaneous on the right, both together, would be the full amount of the cash paid out during that day.

Q. Now, is there a total shown as cash paid out on [445] sheet for September 25, S-8 of Exhibit M?

A. Yes, sir.

Q. What is the total paid out? A. $153.58.

Q. Did you use that figure in computing the purchases of the French Cafe for the entire year; would that figure be included?

A. You mean the purchase by check?

Q. The purchases for the French Cafe?

A. Well, we had both check purchases and cash purchases.

Q. I see. And—— A. Yes, sir.

Q. Where would you get your cash purchases?

A. From these daily sheets.

Q. From these daily sheets? A. Yes, sir.

Q. What was your practice, Miss Goldstein, would you record each day's purchase in your other book? A. No, sir, I would do it monthly.

Q. You would do it monthly? A. Yes, sir.

Q. Then you would go through these daily slips and total the cash purchases; is that right, sir?

A. Yes, sir; yes, sir. [446]

(Testimony of Rose Goldstein.)

Q. Did you do that in each of the years involved, Mrs. Goldstein? A. Yes, sir.

Q. 1942, 1943, 1944, 1945, and up to May 6, 1946?

A. June 6, 1946.

Q. June 6? A. Yes, sir.

Q. All right.

The Court: That is for the French Cafe?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Referring to the year 1944, Miss Goldstein, Exhibit 4F, the income tax return of Walter F. Rau, Sr., for that year, turning to a schedule contained in that income tax return, and exhibit headed the French Cafe, year 1944, would you state the amount shown therein as purchases? A. Yes, sir.

Q. What is the amount, please?

A. Purchases is $55,944.92.

Q. Could I have that last answer, please?

A. $55,944.92.

Q. That is the amount shown in the income tax return for the year 1944, Walter F. Rau, Exhibit 4F? A. Yes, sir.

Q. Under the French Cafe, shown as purchases? [447] A. Yes, sir.

Q. Do you know whether or not that figure is correct, Mrs. Goldstein?

A. Well, I can't say right now, offhand.

Q. Well, Miss Goldstein, did I ask you to examine this figure and also to examine the records of the French Cafe, showing purchases to determine

(Testimony of Rose Goldstein.)

whether or not the figure shown there under purchases is correct; did I ask you to do that?

A. No, sir. They are incorrect.

Q. It is incorrect? A. Yes, sir.

Q. Now, you can—did you examine your work, or your books relating to the French Cafe, purchases, that is this——

Mr. Simpson: If your Honor please——

Q. (By Mr. Gardner): The book right here in the courtroom, did you examine that and compare the purchases shown in that book with the purchase figure shown on Exhibit 4F; did you do that?

Mr. Simpson: I don't understand what counsel means by that book. When we get the record it is not going to be clear to me, as to what this witness examined in connection with this return, in picking a figure out of that return and [448] saying that book, and then asking for a conclusion.

The Court: Government counsel will identify the book.

Q. (By Mr. Gardner): The book referred to in the question relates to the——

A. Cancelled checks.

Mr. Gardner: Records maintained for the French Cafe for the period January 1, 1941, to June of 1946; it shows therein——

Mr. Simpson: May I ask if counsel is testifying with respect to this record.

Mr. Gardner: I am identifying a book, if the Court please.

Mr. Simpson: I submit, sir, that he lay the

(Testimony of Rose Goldstein.)

proper foundation for the purpose of identifying this record that he is talking about.

Mr. Gardner: Very well, your Honor.

The Court: Will you have the clerk stamp it.

Mr. Gardner: Yes, I will.

The Clerk: Respondent's Exhibit U marked for identification.

(The document above referred to was marked Respondent's Exhibit U for identification.) [449]

Q. (By Mr. Gardner): Miss Goldstein, I hand you what has been marked Exhibit U for identification and ask whether or not you can identify this book? A. Yes, sir.

Q. Has that book—what is that book?

A. That is my cash journal where I kept my records of Southern Hotel, French Cafe, and Southern Wine and Liquor.

Q. For what years?

A. From 1943, I think, or 1941, up until 1946, June 6, 1946.

Q. Now, you are speaking of the French Cafe when you say up to June 6 of 1946, aren't you?

A. Yes, sir.

Q. Now, did I ask you, Miss Goldstein, to examine the purchases shown in Exhibit U, for the year 1944, and compare the total per books with the total on the income tax return, Exhibit 4F?

A. Well, this was all monthly, so I didn't have the total year.

(Testimony of Rose Goldstein.)

Q. Yes.

A. And, whether I have it in that ledger, I don't know, but I would have to take each month, take a register tape, register receipt and get my amount.

Q. Well, do you recall whether or not you did that, [450] Miss Goldstein?

A. Yes, sir. That is the way I had to get it, in order to get my amount of purchases for the year.

Q. Yes, and did you do that just recently for me, did you compute that? A. Yes, sir.

Q. And did you compare the amount?

A. Yes, sir.

Q. Per books with the amount on that?

A. Yes, sir.

Q. Would you state now whether or not purchases shown in Exhibit 4F, under the French Cafe, in the amount of $5,594—wait a minute—$55,944.92 is correct, or coincides with the amount in the books? A. No, sir.

Q. What is the difference, Miss Goldstein?

A. Well, it would be approximately about $10,000 that I would have to add on.

Mr. Simpson: If your Honor please, now counsel has asked her if she has made the comparison. It was not correct, she stated a conclusion. Now, she says approximately. I think that we are entitled to the exact amount of difference.

Mr. Gardner: May I develop that. I think I can get the exact amount here.

The Court: Proceed. [451]

(Testimony of Rose Goldstein.)

Q. (By Mr. Gardner): Does the figure shown as purchases, does that contain an erasure on Exhibit 4F for the French Cafe? A. Yes.

Q. And what was the figure originally put in there, if you can see it?

A. You mean before?

Q. Yes. A. $45,000.

Q. $45,000? A. Yes, sir.

Q. And you increased that by ten?

The Court: Was it $45,000 even?

The Witness: Yes, sir.

Mr. Gardner: No.

Mr. Simpson: Mr. Gardner, I would suggest that you let the witness testify, sir.

Mr. Gardner: I am merely trying to keep the record straight.

The Court: What was the amount before the erasure?

The Witness: $45,944.92.

Mr. Simpson: Well, if the Court please, this is very confusing to me. There is an erasure, this witness testifies that there was a four in place of the five, and from what I can see, I can see no other figure than a five on this [452] exhibit.

The Court: That is subject for cross-examination.

Mr. Gardner: If the Court please, the books are here in evidence, and Mr. Simpson wants to save time, he can run these purchases as they are shown on the records, and come up with the figures which the witness is testifying to, I believe.

(Testimony of Rose Goldstein.)

The Court: That is another matter, Mr. Gardner. The question that is presently pending, or that the witness was answering, had to do with the specific figures that appeared upon Exhibit 4F.

Mr. Gardner: Yes.

The Court: What there was before the erasure and what after?

Q. (By Mr. Gardner): Did you make the erasure on there, Miss Goldstein?

A. Well, I put the amount over that; whether I erased it or not, I can't recall.

Q. Is that your figure, the five, relating to Exhibit 4F, French Cafe purchases? A. Yes.

Q. That is your figure? A. Yes, sir.

Q. Could you state whether or not you had any conversations with Mr. Rau regarding the insertion of the [453] figure five, as you have just stated?

A. Well, the way I would have to bring—how I came to that——

Q. Did you have any conversations with Mr. Rau? A. Yes, sir; yes, sir.

Q. Could you state what was said?

A. When I had the figure prepared to put in the income tax blank, I showed them to Mr. Rau, and I told him that he had a tax to pay. He said, "Raise the purchases," because even if you had a small tax to pay, than to pay the amount—and I told him, "Mr. Rau, leave it the way it is." He instructed me to raise the purchases.

Q. Did you raise the purchases?

(Testimony of Rose Goldstein.)

A. I did, on his orders.

The Court: You raised it from what to what?

The Witness: From $45,944.92 to $55,944.92.

The Court: Now, did the purchases as shown in Exhibit U for that year add up to exactly $45,-944.92?

The Witness: Yes, sir.

The Court: I presume that Counsel for Petitioner will have an opportunity to check these figures in Exhibit U?

Mr. Simpson: Yes. I thought, in the interest of time, if Counsel had no use for this January cash journal, we could be adding these figures.

The Court: This is a good time to recess for the [454] afternoon and I will give you an opportunity to do it right now.

We will reconvene tomorrow morning at 10:00 o'clock.

(Whereupon, at 4:00 o'clock p.m. the hearing in the above-entitled matter was adjourned until 10:00 o'clock a.m., July 2, 1958.) [455]

The Clerk: Estate of Walter F. Rau, 61480.

Mr. Gardner: Should we state our appearances for the record, or just continue?

I call Miss Rose Goldstein.

ROSE GOLDSTEIN

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Direct Examination
(Continued)

By Mr. Gardner:

Q. Now, Miss Goldstein, I believe you were in the courtroom when Mr. Webb was testifying, and he testified regarding certain checks that he would make out to cash and label in the check stub "supplies." This relates to the French Cafe for the years 1942, 1943, 1945 and up to May 6 of 1946.

Do you recall that testimony?

A. Yes, sir.

The Court: You skipped 1944, Mr. Gardner.

Mr. Gardner: I intended to include that.

The Court: Did you intend to include that?

Mr. Gardner: Yes, I did, and 1944.

The Witness: Yes, sir.

Mr. Simpson: If your Honor please, if Counsel intends to use the French Cafe daily sheets on which are [458] reflected the cash pay outs, I will be willing to stipulate that, to save him the trouble of going through each year with this witness.

Mr. Gardner: As I understand it, Counsel is willing to stipulate that the amounts reflected in the check stubs for the French Cafe for the years 1942 up to May 6 of 1946 shown as cash and for supplies, are represented on these Exhibits 20, 22, 23, and 24, that should be amended to state as follows: That the amounts about to be shown to Miss

(Testimony of Rose Goldstein.)

Goldstein in the—and the check stubs of French Cafe for years 1942 up to May 6, 1946——

The Court: May or June?

Mr. Gardner: It is May 6, your Honor, I believe, according to stipulation.

Are reflected in Exhibits 20, 22 and 23.

The Court: I don't understand that stipulation.

Mr. Gardner: Well, I would prefer to go through it, your Honor.

The Court: Suppose you go through at least one of the items, then we can see where we stand on it.

Mr. Gardner: Very well.

The Court: The stipulation as it has been formulated up to this point is not very meaningful to me.

Q. (By Mr. Gardner): Miss Goldstein, referring to Exhibit 20, going [459] to the date of December 22, 1943, at the bottom of the page is a summary apparently of that sheet.

Would you state what that sheet is, please?

A. That is the daily cash sheet from the French Cafe.

Q. From the French Cafe? A. Yes, sir.

Q. And these figures at the bottom, Miss Goldstein, could you tell us what this summary consists of?

A. Well, the first figure is registered reading, and then where there would be some meal tickets, which was added, less that, because meal tickets were rung up in the full total.

Q. I see.

(Testimony of Rose Goldstein.)

A. And then the payouts would be deducted from that, which would leave a balance of $298.69.

Then the $10, that was taken out for Mr. Rau, which would leave a balance of $288.69. This check for $31.45 is to represent cash supplies.

Q. Cash supplies?

A. Which was added to the deposit to make it over the $300.

The Court: Did they represent actual cash supplies or did that figure represent merely a check that was drawn to cash purportedly for [460] supplies?

The Witness: There was no supplies bought for that amount, your Honor.

Q. (By Mr. Gardner): Now, referring to Exhibit T, under date of December 23, 1943, check stub No. 3269, this check stub shows a check being made to cash in the amount of $31.45, and in the remarks column it shows supplies?

A. Yes, sir.

Q. Now, did you record this amount, $31.45, as supplies for the French Cafe in the year 1943, Miss Goldstein?

A. I did, in my cash journal, and put it under purchases.

Q. You put it under purchases?

A. Yes, sir.

Q. And you knew at that time that there were no supplies actually purchased, didn't you, Mrs. Goldstein?

A. According to that, no, because I asked once

(Testimony of Rose Goldstein.)

what that amount was for, and I was instructed that it was to put it under purchases.

Q. Who did you ask, Miss Goldstein?

A. Well, I asked Mr. Webb, and then when Mr. Webb wasn't there, I also asked, well, Mr. Rau was there at the time, also.

Q. Did you ask more than once?

A. Well, when there was no indication what it was [461] I had to ask what it was for.

Q. But this shows supplies on the stub, doesn't it? A. Yes, sir.

Q. Is that where you got your information?

A. Yes, sir.

The Court: Did you similarly record under purchases the items appearing in all similar check stubs of the check book of the French Cafe for all the years involved?

The Witness: Your Honor, I did it at first, and then Mr. Rau told me to wait at the end of the month and add up the cash supplies, plus that amount and put it under one check and cash.

The Court: In one form or another, every one of these items was included on the books as purchases?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Did that apply to each of the years 1942, 1943, 1944, 1945, and up to May 6, 1946? A. Yes, sir.

The Court: And upon whose instructions did you make those entries?

The Witness: By Walter F. Rau, Sr., and Robert Webb.

The Court: Both of them?

(Testimony of Rose Goldstein.)

The Witness: Yes, sir.

Mr. Gardner: If the Court please—— [462]

The Court: And when you came to make out the income tax returns, were those amounts similarly reflected in the computation of the income?

The Witness: Yes, sir.

The Court: Of each of those years?

The Witness: Yes, your Honor.

Mr. Gardner: If the Court please, I would like to introduce check stubs for the years, portion of each of the years in support of Miss Goldstein's testimony.

Mr. Simpson: If your Honor please, it won't be necessary, I think that we have now probably arrived at a basis for the stipulation, if your Honor pleases, now understands the nature of what was testified to, with one exception, that is that Miss Goldstein also testify that those amounts also appearing as supplies on the check stubs also appear on the daily sheets of the French Cafe, and are recorded as additional income and not just money deposited in a bank, as she stated, then we will have the basis for the stipulation; won't be necessary to go any further with it.

Mr. Gardner: If the Court please, I believe that Mr. Webb made that clear, that he did add that to the receipts.

Mr. Simpson: Yes. Well, if she stipulates differently, that is one thing, but I thought the record [463] ought to be consistent; save a great deal of time doing it that way.

(Testimony of Rose Goldstein.)

The Court: I am perfectly happy to receive a stipulation of Counsel. My difficulty with this proposed stipulation a few minutes earlier was that in the endeavor to formulate it, on the spur of the moment, the stipulation, the proposed stipulation that emerged was not a meaningful or a very clear one.

I want to make another effort at it. I would be perfectly happy to have you do so.

Mr. Gardner: I would hesitate to try on the spur of the moment, your Honor.

The Court: Let me ask the witness this:

You heard Mr. Webb testify, I take it, Miss Goldstein?

The Witness: Yes, your Honor.

The Court: And as I recall his testimony, these checks that were made out to cash, and which were identified in the, on the check stubs as having been made out for supplies——

The Witness: Yes, sir.

The Court: ——were added to the receipts of each day.

The Witness: Not to the receipts. The balance of the receipts, after the cash supplies were first taken off, and plus the $10 taken off, and then that check was added. [464]

The Court: But the net effect of that, of such a check, was to increase the receipts by the amount of that check?

The Witness: Yes, sir.

The Court: So that when you subsequently re-

(Testimony of Rose Goldstein.)

corded these checks on the books, as amounts expended for purchases or supplies——

The Witness: Yes, sir.

The Court: ——the net effect was simply to neutralize the inclusion of the amounts of those checks on the daily sheets?

The Witness: Yes, sir.

The Court: On the one hand the daily income was increased by the amount of those checks, but on the other hand, by your including them in purchases, the purchases simply washed out the increased amount of the daily receipts?

The Witness: Yes, your Honor.

Mr. Gardner: And that——

The Court: I think I understand it.

Mr. Simpson: Yes. Your Honor, you have a clear understanding that is exactly what transpired, and I could see that if Mr. Gardner was to pursue the same thing that we covered with Mr. Webb, it would be a complete repetition of what he already testified to, the net effect of which would be a standoff. It would be neutralized because of [465] the way it was handled in the books and in the return.

I am perfectly willing to stipulate she will testify this way, and dispense further questioning along those lines. Now, that is clear to your Honor?

Mr. Gardner: I want the record to show that——

Mr. Simpson: It should show that——

Mr. Gardner: ——exactly what she testified to——

(Testimony of Rose Goldstein.)

The Court: I think I understand it, and I think there is no dispute between Counsel as to this point.

Nevertheless, I will permit Mr. Gardner to make it clear beyond any residual doubt, if he wishes.

Mr. Gardner: I don't desire to prolong this thing, if the Court please.

The Court: You may go ahead.

Q. (By Mr. Gardner): I believe that you testified, Miss Goldstein, that in some cases you recorded the exact amount in your records; is that correct? A. Yes, sir.

Q. That is the exact amount of the check stub showing a check to cash for supplies?

A. Yes, sir.

Q. As testified to by Mr. Webb. Now, would you examine check stub No. 3394 a part of Exhibit T, dated January 6, 1944, and state the amount shown therein? [466]

A. The amount stated here is $62.30.

Q. Referring to Exhibit U, for identification, Miss Goldstein, would you look on there and see whether or not you can find the check to supplies in the amount of $62.30 under date of January 6, 1944, recorded? A. Yes, sir.

Q. Recorded in your records?

A. Yes, sir.

Q. And what is the record that you have there, Miss Goldstein?

A. I have the cash supplies, check number under my bank, $62.30, brought over under purchases, $62.30.

(Testimony of Rose Goldstein.)

Q. And that relates to the date of what?

A. January 6, 1944.

Q. What page number—we do not have pages here, your Honor.

A. Well, it is cash journal 1.

Q. Cash journal 1 of the French Cafe; is that correct? A. Yes, sir.

Q. Of Exhibit U; is that correct?

A. Yes, sir.

Q. Now, as I understand it, in other months you lumped or added up these checks payable to cash for supplies; is that correct? [467]

A. Yes, sir.

Q. And then you included them in purchases in these very same records, Exhibit U?

A. Yes, sir.

Q. And these very same records, Exhibit U, are the records that you used to prepare the income tax returns, are they? A. Yes, sir.

Q. That applies to each of the years 1942, '43, 1944, 1945, and 1946; is that correct?

A. Yes, sir.

Q. Now, in each of those years purchases was overstated in a like amount as shown on these cash supplies; is that correct? A. Yes, sir.

Q. Now, there is one further point relating to purchases, Miss Goldstein. I hand you Exhibit 3E, the individual income tax return of Walter F. Rau for the year 1943, and turning to the schedule therein marked French Cafe, it has a gross sales, it has inventory, and it has purchases.

(Testimony of Rose Goldstein.)

Now, during that year, it says purchases made during the year, $66,791.12. Do you see that figure, Miss Goldstein? A. I do.

Q. At my request, did you examine your records and [468] total the purchases according to your records, that is Exhibit U, for identification, to determine the total amount of purchases in your records? A. Yes, sir.

Q. And according to those records, what was the total amount of purchases that you had in Exhibit U, for 1943?

A. For 1943, the French Cafe total of purchases taken from my cash journal, from January 1, 1943, up to and including December 31, 1943, was $48,503.91.

Q. Now, would you read once again the total that you have on the income tax return, please?

A. $66,791.12.

Q. And purchases are considerably overstated then in the income tax return, are they not, Miss Goldstein? A. Yes, sir.

Q. Do you know why this was done?

A. Yes, sir.

Q. Would you state the circumstances surrounding the insertion of $66,000 some odd dollars as purchases on the income tax return Exhibit 3E?

A. When I had the income tax figures made up, I took them over to Mr. Rau, to have him check them, showed what tax he had to pay. He told me to boost the purchases so he wouldn't have much

(Testimony of Rose Goldstein.)

income tax to pay, or none, and I [469] did it according to his instructions.

The Court: Now, you testified that the purchases shown on the books were $48,503.91?

The Witness: Yes, sir.

The Court: Now, did that figure include the amounts that appeared on the check stubs with respect to checks made out to cash for supplies, where the supplies were not in fact purchased?

The Witness: Yes, your Honor.

The Court: So that even the $48,503.91 figure was an inflated figure?

The Witness: You mean were those extra checks?

The Court: Yes.

The Witness: Yes, sir.

The Court: But to the extent of that, that it was inflated in the $48,503.91, that inflation was offset by the similar or rather a corresponding artificial increase in the amount of receipts?

The Witness: Yes, your Honor.

The Court: But the increase, however, from $48,503.91 to $66,791.12 was not offset by any corresponding——

The Witness: No, sir.

The Court: ——corresponding increase in receipts?

The Witness: No, your Honor. Do you want this, your Honor? [470]

Q. (By Mr. Gardner): Now, Miss Goldstein, you heard the testimony of Mr. Webb to the effect

(Testimony of Rose Goldstein.)

that he prepared these daily slips for the French Cafe in each of the years 1942, on up to May 6, 1946, did you not? A. Yes, sir.

Q. And he stated that when he was absent, or when he went on away for a couple days, or he was sick, that you took over for him; is that correct, Miss Goldstein? A. Yes, sir.

Q. And did you carry on, that is, did you make out the daily slips as Mr. Webb testified he made out the daily slips?

A. Just about, in part.

Q. Just about, in part? A. Yes, sir.

Q. In order to refresh your recollection, I will hand you once again Exhibit 20, and we will go to the first one on that exhibit under date of September 20, would you tell me what that ten represents in the summary on the right side of the sheet?

A. That was $10 that was taken out for Mr. Walter F. Rau, Sr.

Q. Now, during the times that Mr. Webb was absent, just exactly what did you do; did you receive the receipts [471] from the French Cafe?

A. I did.

Q. Did you receive the receipts from the Southern Wine and Liquor store? A. I did.

Q. Now, when you received the receipts from the French Cafe, would you state just exactly what you did, Miss Goldstein?

A. I did according to what Mr. Webb instructed me to. I put the total receipts, less the payouts,

(Testimony of Rose Goldstein.)

less the amount $10, to Mr. Rau, and added that cash supply check.

Q. Now, what about the Southern Wine and Liquor? A. Did the same thing.

Q. You did the same?

A. Although there wasn't many cash payouts there.

Q. What did you do with the money?

The Court: What was the amount that was taken off for the bar, or the Southern Wine and Liquor Company?

A. Every day of the week was $25.

Q. (By Mr. Gardner): Did you ever have occasion to take off any more than $25, Mrs. Goldstein?

A. Oh, Mr. Rau's orders on Saturdays, Sundays or holidays.

Q. How much would you take off then? [472]

A. You mean from the cafe, or the bar, which?

Q. Well, let's talk about the French Cafe, first.

A. Well, on the French Cafe on Saturdays, Sundays and holidays, he would take off from $100 to $125, or $150.

Q. Now, did that apply for the years 1942 to May 6 of 1946?

A. Yes, sir, your Honor; yes, sir.

Q. In each of those years; is that correct, Mrs. Goldstein? A. Yes.

Q. You did this personally on occasion?

A. Well, I did it in Mr. Rau's presence, when Mr. Webb wasn't there.

(Testimony of Rose Goldstein.)

Q. Now, going to the Southern Wine and Liquor Store, how much would take off of the Southern Wine and Liquor Store during the week?

A. $25 a day, Saturdays and Sundays and holidays, Mr. Rau would tell me the amount to take off.

Q. Did you do this during each of the years 1942 to 1947, inclusive? A. Yes, sir.

Q. Up until the time that the Southern Hotel was torn down in August 7 of 1947; is that correct? A. Yes, sir. [473]

Q. In each of those years, you took off money, $25 during the week and $100 or more as instructed by Mr. Rau from the Southern Wine and Liquor Store?

A. No, not from the Southern Wine and Liquor.

Q. How much did you take off?

A. Well, he would instruct from 125 up to 200.

Q. From 125 to 100?

A. 2599, and a little bit more.

Q. That would include Saturdays, Sundays and holidays? A. Yes.

Q. And $25 every day? A. Yes, sir.

Q. From the Southern Wine and Liquor?

A. Yes, sir.

Q. Now, as to the French Cafe, you took off $10 every day and $100 up to $125 or $150 on Saturdays, Sundays and holidays? A. Yes, sir.

Q. And that extended throughout the period 1942 to May 6 of 1946, as to the French Cafe; is that correct? A. Yes, sir.

Q. In each of those years you did that?

(Testimony of Rose Goldstein.)

A. Well——

The Court: On week ends, or days on which more than [474] $10 was taken out for the cafe and more than $25 was taken out for the Southern Wine and Liquor Company, with two amounts taken out for each one of those, that is to say, take the French Cafe, let's assume it was a Saturday——

The Witness: Yes, sir.

The Court: Were two amounts taken out for that Saturday, was $10 taken out separately and then another amount taken out over and above the $10, or was it taken out in one lump sum?

The Witness: One lump sum, to the best of my recollection.

Q. (By Mr. Gardner): Now, as you take out the $10 daily from the French Cafe, what did you do with that $10, Miss Goldstein?

A. There was a little slip in Mr. Rau's key box and on that slip, which Mr. Rau was present, I would put the date down and the amount of $10 and put it back in that cubby hole for, where his key was kept.

Q. And relating to the $25 daily that you would take out of the receipts of the Southern Wine and Liquor Store, what did you do?

A. The same thing; the same thing.

Q. Now, as to the amounts on week ends, relating to the French Cafe, that is the amounts of $100 to $125, what would you do with that [475] money?

A. That I would put in an envelope until Mr.

(Testimony of Rose Goldstein.)

Webb would come back on Monday morning, and I would give, hand him all the records.

Q. In other words, you were just keeping these records for Mr. Webb, weren't you?

A. Yes, sir.

Q. You would give it to him?

A. Yes, sir.

Q. And then he would make proper disposition?

A. Yes, sir.

Q. Now, as to the amounts that you removed from the receipts of the Southern Wine and Liquor Store, on Saturdays, Sundays and holidays, that is, the larger amounts, $125 up to $200, I believe you testified, what did you do with that money?

A. Same procedure was done on the Southern Wine and Liquor, as I did on the French Cafe.

Q. Now, Mrs. Goldstein, you kept the books and records for the French Cafe and for the Southern Wine and Liquor during the years 1942 on up through 1947; didn't you? A. Yes, sir.

Q. Can you state whether or not your records were correctly kept as to the receipts of the French Cafe and the Southern Wine and Liquor Store?

A. The only record I got for the receipts of the [476] French Cafe and Southern Wine and Liquor was from those daily books where Mr. Rau put the deposits and those deposits was transferred into my books as receipts.

Q. Now, that applies to each of the years 1942 to 1947, doesn't it, Miss Goldstein?

A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. That relates to the receipts of the Southern Wine and Liquor Store and the French Cafe?

A. Yes, sir.

Q. For each of those years? A. Yes, sir.

Q. You are referring to these daily year books, are you not? A. Yes, sir.

Q. That is Exhibits R, O——

The Court: She was nodding in the affirmative.

The Witness: Yes.

Q. (By Mr. Gardner): ——N?

A. Yes, sir.

The Court: Did I get your answer to Exhibit R?

The Witness: Yes.

Q. (By Mr. Gardner): Yes. Exhibit O?

A. Yes. [477]

Q. Exhibit P? A. Yes.

Q. Exhibit Q? A. Yes.

Q. And Exhibit S? A. Yes, yes.

Q. Now, you knew that those receipts were understated then, didn't you, Miss Goldstein?

A. Yes, sir.

Q. Did you have any discussions with Mr. Rau regarding the understatement of the receipts from the French Cafe and the Southern Wine and Liquor Store? A. I did.

Q. Would you state when the first discussion you had with Mr. Rau took place?

A. Well, when I was taking Mr. Webb's place at the time, either on week ends or when he was sick, or on his vacation. I told Mr. Rau that the right receipts should have been kept in those year

(Testimony of Rose Goldstein.)

books, not the deposits, and he says I should go ahead the way that it had been done.

Q. Did you have a discussion with Mr. Rau in the year 1942 concerning this, Miss Goldstein?

A. Yes, sir.

Q. Did you have a discussion with Mr. Rau in the year 1943? [478] A. Yes, sir.

Q. Did you have more than one discussion?

A. When the income tax was to be made up, I told him that he is putting in a false income. I mean, receipts, that he wasn't putting in the right amount, that the full amount of receipts should be put in before anything was taken out as an income. He told me to go according to the deposits.

Q. Did you have a discussion with him in 1944?

A. Yes, sir.

Q. To the same effect? A. Yes, sir.

Q. 1945? A. Yes, sir.

Q. You had a discussion with him in 1945?

A. Yes, sir.

Q. To the same effect regarding these understated receipts for the French Cafe and the Southern Wine and Liquor? A. Yes, sir.

Q. And what would his answer be in each of those years? A. The same thing.

Q. And what was that again?

A. That to go according to the deposits, to [479] show his receipts, and not the full receipts, before any deduction was taken out.

Q. Did you inform him clearly that his income tax was understated?

(Testimony of Rose Goldstein.)

A. I told him that, and I told him that he should put in the right amount.

Q. Did you have a discussion with him in 1946 regarding the understated receipts from the French Cafe, and the Southern Wine and Liquor Store?

A. I did.

Q. And was his answer the same as in previous years?

A. Yes, sir. He told me to go according to what they instructed me to do.

Q. They, meaning who?

A. Mr. Webb and Mr. Rau.

Q. Did you have a discussion with him in 1947 relative to this understatement? A. I did.

Q. That would be when you were preparing the 1946 income tax return; is that correct?

A. Yes, sir.

Q. Now, after you prepared the 1946 income tax return, and in 1947, the French Cafe was then a partnership, I believe, in that year?

A. It was. [480]

Q. It was. But the same practice was being observed by the Southern Wine and Liquor Store; wasn't it? A. Yes, sir.

Q. That is they were understating their receipts each day? A. Yes, sir.

Q. Did you have any discussion with Mr. Rau?

A. I did.

Q. During 1947 regarding the omissions in 1947?

A. That is when I told Mr. Rau that he had better, the tax shown, instead of increasing the

(Testimony of Rose Goldstein.)

supplies and so forth, because he will be caught and I said we will get all blamed for it on account of him.

Q. What did he say?

A. He said, "You go ahead the way I am telling you what to do," and he said, "The Government will not catch up with me." That is just the words; Mr. Webb was there at the time.

The Court: When did that discussion take place?

The Witness: When I was preparing the 1946 income tax.

The Court: When you were preparing the '46 return?

The Witness: Yes, sir, and showed him the records according to my books.

The Court: That was in 1947? [481]

A. Yes, sir.

The Court: Where did it take place?

The Witness: Right there in the Southern Hotel lobby, in back of the office there, in back of the desk.

The Court: In back of the office?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Who else was present, Miss Goldstein?

A. Mr. Webb was there also.

The Court: Did you have any discussions with respect to the year 1947, itself?

The Witness: The same thing I told him, also.

Q. (By Mr. Gardner): Did you have more than

(Testimony of Rose Goldstein.)

one discussion with him during the year, during each of these years, regarding the income tax?

A. Oh, at different times I would tell him.

Q. At different times during each of the years?

A. Yes, sir.

Q. Did you tell him more than once in 1947, regarding the understatement of income, relative to the French Cafe, and the Southern Wine and Liquor Store?

A. Well, up until the hotel was demolished in '47. After that I didn't have nothing more to do with that.

Q. Now, what did you do with the books and records [482] of the French Cafe, and the Southern Wine and Liquor Store, after the hotel was demolished?

A. They were left there in the back office on the shelf there with the files.

Q. They were left in the back office?

A. Yes, sir.

Q. And did those records for the year 1947 show understated receipts for the French Cafe and the Southern Wine and Liquor Store?

A. Yes, sir.

Q. In other words, the income was understated, wasn't it? A. Yes, sir.

Q. In substantial amounts? A. Yes, sir.

Q. And the understatement resulting, or the understatement that you had informed Mr.—the understatement that you had informed Mr. Rau as to the year 1947, was the same understatement that

(Testimony of Rose Goldstein.)

was reflected in your books and records; is that correct? A. Yes, sir.

Q. Now, I would like to get back to the purchases, Mrs. Goldstein; according to these daily slips, that is Exhibits 21, 22 and 23; show once again Exhibit 21 as being illustrative of these other exhibits, by the time [483] we get down to the deposit, I notice that the supplies and the payouts have already been deducted from the gross receipts; is that correct? A. Yes, sir.

Q. And do I understand that in the year 1943 you put down, or recorded purchases in your records, maintained for the French Cafe?

A. Yes, sir.

Q. Now, the purchases have already been removed once on those daily slips, haven't they, Mrs. Goldstein? A. They have.

Q. Then any purchases that you record in your books and records are false, aren't they?

A. Yes, sir.

Q. They are duplications? A. Yes, sir.

Mr. Simpson: If your Honor please, I will be indulging with the leading statements and making conclusions in the interest of time, but this one I will have to object to.

The Court: These past few questions were leading. Counsel will endeavor to——

Mr. Gardner: Very well, your Honor.

The Court: ——not to lead the witness.

Mr. Gardner: Very well. [484]

Q. (By Mr. Gardner): Now, purchases for the

(Testimony of Rose Goldstein.)

French Cafe as shown on these daily slips, Mrs. Goldstein, I believe you have testified to the fact that the purchases were removed prior to the time that you reached a final figure, showing the day's receipts? A. Yes, sir.

Mr. Simpson: He is leading the witness again, your Honor.

Mr. Gardner: If the Court please, she has already testified to that.

The Court: In a sense, Counsel is merely summarizing what appears on the sheets.

Mr. Simpson: Yes, your Honor, but he is doing so in a way that he is leading her now, because of the way that he is doing it. He is now getting from this witness a conclusion that the purchases that she has on here have already been taken off prior to the time that they were written down here.

The result will be from the testimony that he is eliciting from her will be that they will be a duplicate deduction claimed for supplies and purchases, whereas we have already gotten from this witness that they neutralized each other, as your Honor understood it.

The way he is approaching it now, he will have the deductions coming out again, or that they should be [485] taken out again.

The Court: I am not sure you are using the word "purchases" in the same sense that the word purchases or supplies was used in connection with the so-called neutralizing items. Those neutralizing items, as I understood it, related only to those checks that were made out to cash in which rep-

(Testimony of Rose Goldstein.)

resented fictitious purchases, and not actual purchases.

I understood Counsel's last few questions to relate to actual purchases and not to the fictitious purchases.

Mr. Simpson: I may have misunderstood his question, the purpose for it, now.

The Court: Do I understand your question, did I misunderstand your question?

Mr. Gardner: No, your Honor.

The Court: The questions you were just putting to this witness right now related to the actual purchases, and not to the fictitious purchases that were neutralized?

Mr. Gardner: That is correct, your Honor.

Mr. Simpson: If your Honor please, I will stipulate that those purchases are on here, if that is what she is testifying to, within the journals.

Mr. Gardner: Will you stipulate that they are in there twice, then? If you will stipulate they are in there [486] twice, we can dispense with all this testimony.

Mr. Simpson: That is the whole point, the way I understood it is that he is now going to attempt to establish through this witness that there are double deductions for purchases; that is what I objected to, and he was leading her to come to that conclusion.

Mr. Gardner: That is exactly what I am going to establish.

The Court: Counsel may continue.

(Testimony of Rose Goldstein.)

Mr. Gardner: Thank you, your Honor.

Q. (By Mr. Gardner): Now, let's go back to this just once again.

The Court: There has been some confusion and I suggest you start over again.

Mr. Gardner: Very well, your Honor.

Q. (By Mr. Gardner): Referring once again to Exhibit 21, under date of January 2, 1944——

The Court: Is that the top sheet?

Mr. Gardner: That is the top sheet, your Honor.

Q. (By Mr. Gardner): There is a summary in the middle of the page, would you read that summary and explain what that summary consists of?

A. For January 2, 1944, the register reading was [487] $552.11.

The Court: What did that represent?

The Witness: The full reading of the 24-hour shift.

The Court: And those, that figure represents the full receipts for that day, for that 24-hour period?

The Witness: For that day, yes, sir. And then in that reading, the $2.55 meal tickets was rung up, which we deducted, which left the receipts $549.56.

The Court: Those are the actual cash receipts?

The Witness: Yes, sir.

The Court: For the day?

The Witness: Yes, sir. And the payouts was $32.57, which left the bank or deposit $516.99, less the $10 that was taken out for Mr. Rau, Sr., which left a balance of $506.99.

Then they added $150 for Mr. Rau, left the bal-

(Testimony of Rose Goldstein.)

ance of $356.99, which was listed as receipts for the French Cafe.

The Court: You say they added $150 or subtracted?

The Witness: They subtracted, pardon me.

Q. (By Mr. Gardner): That was also for Mr. Rau? A. Yes, sir.

Q. Now, going to the payouts here in the amount of $32.57, would you once again pick up that figure and put it [488] in purchases, would you state whether or not you did that? A. I did.

Q. You did pick it up again?

A. Yes, sir.

Q. And you put it in purchases?

A. Yes, sir.

Q. Would that be placed in the book, Exhibit U for identification? A. It was.

Q. Now, would you state just how you arrived at the purchase figures shown for the French Cafe, as reflected in Exhibit U?

A. You are referring to '44?

Q. We are referring to '44. Let's get to '44. There you are. A. Well——

Q. Now, referring to the year 1944, in Exhibit U, relating to the records of the French Cafe——

A. Yes, sir.

Q. ——will you state how you received or where you obtained the information to put your figures down under purchases?

A. Well, I would take the check books, mark the check numbers and the amount, and credit my

(Testimony of Rose Goldstein.)

bank and debit my purchases. At the end of the month, I would take these [489] total cash receipts, add up all the column cash paid.

Q. You are referring to these total cash receipts, you are referring to these, to Exhibit 21, are you not? A. Yes, sir, and total all that.

Q. Total all that, all what, exactly what would you total? A. All the cash payouts.

Q. All the pay, cash payouts?

A. Yes, and put the full amount under the cash on that, and then debit to purchases.

Q. Debit that to purchases? A. Yes, sir.

The Court: What amount would you include for receipts?

A. The deposit, $356.99 on that one.

The Court: So that for the date January 2, 1944, you recorded as receipts the amount of $356.99?

The Witness: Ninety-nine cents.

The Court: And 99 cents. And you subtracted in addition purchases of $32.57?

The Witness: Yes, sir.

Q. (By Mr. Gardner): Now, Miss Goldstein, the net effect of this was to duplicate purchases as to the French Cafe in the year 1944; is that correct? A. Yes, sir.

Q. Did you have any discussions with Mr. Rau concerning [490] these duplications?

A. I did.

Q. What did Mr. Rau say?

A. I told him where he was taking off the purchases twice, that he should have only taken them

(Testimony of Rose Goldstein.)

off once. He told me to go according to the way I was instructed.

The Court: You testified as to what you did with respect to the day of January 2, 1944. I would like Counsel to inquire as to whether similar practice was followed as to other days or years, and, if so, what days or years.

Q. (By Mr. Gardner): Regarding the duplication of purchases which you have just testified, regarding the daily sheet for the year, or for the date January 2, 1944, Exhibit 21, did you follow that practice throughout the year 1944, Mrs. Goldstein?

A. I did.

Q. And did you follow that practice throughout the year '45? A. I did.

Q. Did you follow that practice up to May 6 of 1946? A. I did.

Q. Did you follow that practice in the year 1943?

A. To the best of my recollection, yes, I [491] did.

Q. You did? A. Yes, sir.

Q. Did you follow that practice in the year 1942?

A. Well, I would have to look through the records to see.

Q. All right. Would you look in the records, please, Mrs. Goldstein; you are now looking at Exhibit U for identification; is that correct?

A. Yes, sir; '42.

Q. 1942? A. Not in '42.

(Testimony of Rose Goldstein.)

Q. Not in '42? A. No, sir.

Q. This started in 1943 then?

A. Yes, sir.

Q. Now, I will attempt to summarize your testimony; would you listen closely, please?

Any purchases appearing in your records, that is Exhibit U for identification, for the French Cafe, are a duplication of purchases appearing on the daily slips, and for which you have already taken into account in computing income for the French Cafe; is that correct? A. Yes, sir.

The Court: For what years, Mr. Gardner? [492]

Q. (By Mr. Gardner): Now, that applies to each of the years 1943; is that correct, Mrs. Goldstein?

A. I am looking up '43 to be sure on that.

Q. All right.

Mr. Simpson: If your Honor please, may I suggest a recess at this time while she is looking up this information?

The Court: Very well. There will be a recess.

(Short recess.)

Mr. Gardner: I would like to have this exhibit marked for identification as Respondent's next in order.

The Clerk: Respondent's Exhibit V marked for identification.

(The document above referred to was marked Respondent's Exhibit V for identification.)

(Testimony of Rose Goldstein.)

Q. (By Mr. Gardner): Mrs. Goldstein, during the recess that we just had, did I request you to examine Exhibit U for identification, that is your books and records relating to the French Cafe for the years 1943, 1944, 1945 and 1946?

A. Yes, sir.

Q. Relative to cash purchases shown in your books and records, that is? A. Yes, sir.

Q. Exhibit U? [493] A. Yes, sir.

Q. Did you do that? A. I did.

Q. I hand you what has been marked Exhibit V for identification, and referring to the year 1943, would you state the total amount of cash purchases reflected in your books and records for the French Cafe, that is Exhibit U?

A. You mean from the beginning to the end?

Q. Just the total, if you please.

A. From 1943 it was $17,872.79.

Q. Now, those cash purchases in effect are a duplication, are they not, Mrs. Goldstein?

A. Yes, sir.

Q. In other words, purchases is increased by that amount and you have already taken credit for them previously, haven't you? A. Yes, sir.

Q. Referring to the second page of Exhibit V, for identification, for the year 1944, what did Exhibit U reveal to be your total cash purchases for that year? A. $24,140.70.

Q. And this is the same as in the year 1943, has the effect of duplicating purchases to that extent; is that correct? A. Yes, sir. [494]

(Testimony of Rose Goldstein.)

Q. Now, would you refer to the cash purchases for the year 1945, and state what the total cash purchases shown in your records, Exhibit U, for that year? A. $1,279.14.

Q. This means that purchases are in effect duplicated to that extent for the year 1945; is that correct? A. Yes, sir.

Q. And would you state what the total cash purchases reflected in Exhibit U, as to the year 1946, are? A. $1,969.91.

Q. And here, as in the prior years, this means that purchases are duplicated to that extent; is that correct? A. Yes, sir.

Q. Now, all of these cash purchases relate to the French Cafe; is that correct? A. Yes, sir.

Q. In each of these years? A. Yes, sir.

Mr. Gardner: Offer in evidence Respondent's Exhibit V.

Mr. Simpson: No objection.

The Court: No objection.

(The document heretofore marked as Respondent's Exhibit V for identification, was received in evidence.) [495]

Q. (By Mr. Gardner): Now, Mrs. Goldstein, I believe you testified that you knew Mr. Rau from some time around 1935, on through 1947; is that correct? A. Yes, sir.

Q. Directing your attention to the year 1942, what would you say his physical condition was during that year? A. Okay.

(Testimony of Rose Goldstein.)

Q. Did he walk with a cane? A. Not then.

Q. Not then? A. No, sir.

Q. Now, in the year 1942, did he take an active interest in the business? A. Yes, sir.

Q. I am referring now to the French Cafe, the Southern Wine and Liquor, especially, did he take an interest in those businesses; were you able to observe that?

A. Yes; he was there at all times.

Q. What was his mental condition, as a lay person, what was your opinion?

Mr. Simpson: Object, your Honor. This witness is certainly not qualified to testify with respect to Mr. Rau's mental condition. We had that question yesterday in [496] connection with the general practitioner.

The Court: I will not receive any evidence from this witness as an expert on Mr. Rau's mental condition, medically, but I will receive evidence from her as to what she observed as a layman, with respect to his alertness, and general responsiveness.

Mr. Gardner: Would you read the question, please?

(Question read.)

The Witness: To my recollection, he is like any ordinary well man, taking care of his line of duty and his businesses.

Q. (By Mr. Gardner): Did he have many businesses, Mrs. Goldstein?

A. Well, he had those three, Southern Hotel, French Cafe, and Southern Wine and Liquor.

(Testimony of Rose Goldstein.)

Q. Did you have any discussions with him regarding the books and records, the manner in which you kept them and financial matters?

A. Oh, yes. He knew everything that was going on.

Q. Did he make it a practice to know everything that was going on?

A. Oh, yes, sir. We had to show him the check banks; we had to show him whatever was paid out, and what was—what the transactions were.

Q. Did he further direct you as to how to proceed? [497]

A. Yes, sir. I took all instructions direct from him.

Q. Now, continuing through the period involved, that is 1943, 1944, 1946 and 1947——

The Court: You have omitted 1945, I think.

Mr. Gardner: 1945, excuse me.

Q. (By Mr. Gardner): 1946 and 1947, did he continue to keep a close watch over the books and records maintained by you?

A. Well, in '47 he was, he was living out at his home.

Q. I see.

A. But he would come down most—and then in '46, I think, is when he moved out there.

Q. I see.

A. But he came down every day to find out what was going on.

Q. Did it appear to you as his bookkeeper that he knew exactly what was going on?

(Testimony of Rose Goldstein.)

A. Up until the time that I was taking care of the books——

The Court: I don't understand that answer.

The Witness: Up until the time that I took care of the books, and then he went into partnership with Mr. Bender.

The Court: You mean during the time that you kept [498] the books?

The Witness: Yes, sir.

The Court: And that terminated when?

The Witness: When he went in partnership with Mr. Phil Bender.

Q. (By Mr. Gardner): You are now referring to the French Cafe, are you not?

A. Yes, sir.

Q. Did you continue to keep the books of the Southern Wine and Liquor Store?

A. I did.

Q. On up until the time that the Southern Hotel was torn down? A. Yes, sir.

Q. Now, all during this period that you kept the books and records for Mr. Rau, did he maintain a close inspection of these records, and a closer supervision of the records?

A. Yes, because when he came down, he would check, go behind the desk, check the book, and then find out what our payouts were.

Q. Now, in the year 1946, I believe, he had an acute case of phlebitis; is that correct, or do you recall?

(Testimony of Rose Goldstein.)

A. Well, that is when he had that Mrs. Dorsey take [499] care of him then.

Q. Do you recall whether or not he could only walk with a cane?

A. Well, he sometimes walked with a cane.

Q. Now, this is in 1946?

A. To my recollection he would walk with his cane.

Q. Did he have a wheel chair in 1946 or 1947?

A. I have only seen the wheel chair once, when we were at the hotel, where the nurse brought him down to eat, and that is the only time I saw it there. After the hotel—after—I mean, after we left the hotel, in August 17, 1947, when they opened up the French Cafe at Chester and 18th, that is when I also saw him in a wheel chair.

Mr. Simpson: Can we establish, if your Honor please, the first time that you saw the wheel chair in what year was that, approximately what month?

Mr. Gardner: That is what I am trying to get to, your Honor.

Mr. Simpson: Yes.

Q. (By Mr. Gardner): When was the first time that you did see Mr. Rau in a wheel chair?

A. Well, I can't recall the year, but it was after Mrs. Dorsey took care of him.

Q. She started taking care of him when? [500]

A. I couldn't say.

Q. Was it in—is it '46?

A. I can't recall what month, what year it was.

Q. But it is your testimony that during all of

(Testimony of Rose Goldstein.)

these years on up and including the date of August 7, 1947, as long as you took care of the books and records of the Southern Wine and Liquor Company, and the Southern Hotel, that Mr. Rau kept a close watch on the books and records, and a close supervision over the activities of these businesses?

A. Yes, sir.

Q. Now, Mrs. Goldstein, you knew all during these years that Mr. Rau was understating his income, didn't you? A. I did.

Q. On his income tax returns? A. I did.

Q. You knew that he understated his income in substantial amounts in each of the returns filed for the years 1942, 1943, 1944, 1945 and 1946, which you prepared? A. Yes, sir.

Q. And I believe your testimony is that you discussed this with Mr. Rau on each occasion?

A. I did.

Q. Did you subsequently take any steps to inform the Government of the understated [501] income? A. I did.

Q. When did you do this, Miss Goldstein?

A. Well, I don't recall the year, but I took it up with the Bakersfield income tax agent, Mr. Branas.

Q. Mr. Branas? A. Yes, sir.

Q. Have you put in a claim for reward, Miss Goldstein? A. No, sir.

Mr. Simpson: Can we get the date from this witness, on the date she informed the Internal Revenue Service? That hasn't been established yet.

(Testimony of Rose Goldstein.)

Mr. Gardner: No further questions, your [502] Honor.

Mr. Simpson: Can we establish the date?

The Court: You may ask her.

Mr. Simpson: I will get it.

Mr. Gardner: Excuse me. Did I miss something?

Mr. Simpson: I just want to establish the date she informed the Internal Revenue Service, never did establish that.

Cross-Examination

By Mr. Simpson:

Q. In connection with the last question asked of you by Counsel for the Respondent, as to the advising of the Internal Revenue Service, the incorrectness or falsity of Mr. Rau's returns, will you state for the record, please, the approximate date on which you informed the Internal Revenue Service of that condition?

A. I just don't recall what year it was, whether it was '48 or '49, or whether it was before. I can't recall.

Q. Do you recall whether or not it was after he had a stroke, or do you know that he had a stroke in 1947?

A. No, because I wasn't up in his room, or at home there when he had this stroke.

Q. Well, you went out to his home, though, did you not?

(Testimony of Rose Goldstein.)

A. Once in awhile I would visit there, while the nurse was there.

Q. Well, then, if he had a nurse, then you would have known it in 1947, wouldn't you, Mrs. Goldstein?

A. Unless I was told he had one. [503]

Q. You went out to see him in his home. Let's establish that you did that in 1947?

A. I would go out there to visit him.

Q. Well then, if he had a stroke would you have known about it when you went out to see him in 1947?

A. I don't recall whether I would or not.

Q. Well, you knew the man, didn't you?

A. Yes, I did.

Q. And did he have a nurse out there at his home with him?

A. He had his housekeeper, his aid nurse.

The Court: Did you go out to see him after the hotel was demolished?

A. I had gone out and seen him once in a while.

The Court: Even after the hotel was demolished?

The Witness: Yes, sir.

The Court: Were you working for him at that time?

The Witness: No, sir.

The Court: You stopped?

The Witness: Pardon me. I was at the hotel until the hotel was completely demolished, and took everything out.

(Testimony of Rose Goldstein.)

The Court: That was in, approximately in August of 1947?

The Witness: '47, yes, sir.

The Court: Did you work for him after that?

The Witness: Only—no, only to get to close the books for the records of the Southern Hotel and the Southern Wine and Liquor. [504]

Q. (By Mr. Simpson): Now, Miss Goldstein, with respect to your duties, if I understand you correctly, and I don't want to consume too much time on this, you were the bookkeeper for all of the years '42 through '46, up until the time that the partnership was formed by Mr. Rau and Mr. Bender? A. Yes, sir.

Q. You prepared the returns for each one of those years? A. Yes, sir.

Q. How many hours a day and it will also relate to the Southern Hotel, the Southern Wine and Liquor Store, and the French Cafe, and you kept the books on those three businesses?

A. Yes, sir.

Q. Did your duties also encompass those in connection with the Edmund Hotel that Mr. Rau owned?

A. The only time is when he put in the system there at the Edmund Hotel.

Q. Just answer the question. Did you have anything to do with keeping the books?

Mr. Gardner: If the Court please——

Mr. Simpson: I want to know if she kept the books for the Edmund Hotel.

(Testimony of Rose Goldstein.)

Q. (By Mr. Simpson): Did you?

A. No.

Q. Did you keep the books at the Sea Spray Hotel? [505]

A. Only got the books from the manager.

Q. Did you keep the books on the Sea Spray Court?

A. There was no books kept on that.

Q. You did not keep any books?

A. Only from records; that is all.

The Court: Did you have anything to do with the records of that enterprise?

The Witness: No, sir.

Q. (By Mr. Simpson): Now, we have your duties relating to the bar, the French Cafe, and the Southern Hotel. A. Yes, sir.

Q. As far as keeping the books and records is concerned; is that correct? A. Yes, sir.

Q. How many hours a day would you devote to that, Miss Goldstein?

A. I didn't specify any hours at all. Whenever I had time off of my work, I would take care of the books. I had no set hours.

Q. What did you receive as a salary as bookkeeper for the work that you did for Mr. Rau?

A. $10 a month.

Q. $10 a month? A. Yes, sir.

Q. For keeping the records for these three businesses for the years 1942 up to the time the partnership was formed in 1946? [506]

A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. Is that correct?

A. And he gave me my meals from the French Cafe.

Q. And you had your meals? A. Yes, sir.

Q. How many meals, one?

A. Sometimes one, sometimes two.

Q. Were you satisfied with that arrangement of $10 a month for that work?

A. Yes, because I had my desk there in the lobby.

Q. Now, what desk did you have in the lobby?

A. My public stenographer desk.

Q. What else did you do other than being a public stenographer?

A. Notary Public, mimeographing, telephone service, and direct mail advertising; also, I was a deputy registrar, and then I did some court reporting.

Q. Did you also prepare income tax returns?

A. I did, I did income taxes.

Q. Did you keep books and records for anyone else, other than Mr. Rau? A. No, sir.

Q. You were a bookkeeper for him only, and for no one else? A. Yes, sir.

Q. Now, when Mr. Webb was away from the hotel, did you take over his duties as clerk in the hotel?

A. What part are you referring to, when he was away [507] from the hotel?

Q. Well, during this period from 1942, up through 1946, Mr. Webb has testified, you were in

(Testimony of Rose Goldstein.)

the courtroom, you heard him say that there were times when he wasn't there, and that somebody else would relieve him. I think he mentioned you, on occasion, that you did relieve him.

A. I relieved him during the day from 12:00 to 2:00, when he went up to take his nap.

Q. Mr. Webb took a nap?

A. Yes, sir. And then on Sunday, I—he would work a short, I think I would relieve him, either at 10:00 or 12:00 noon, and then the next Sunday, I would relieve him all day.

Q. With respect to the office that you had, as public stenographer, direct mail advertising, telephone answering service, preparing income tax returns, mimeographing, when did you begin that business in Bakersfield, what year?

A. Oh, I can't recall just when I started as public stenographer.

Q. Was it before 1942?

A. Oh, yes. Approximately——

Q. All before 1942, well, before 1942?

A. Yes, sir.

Q. Was it as early as 1935?

A. No, sir. I don't think so.

Q. Was it some place between 1935 and 1940?

A. It was after the Judge was defeated in [508] the Justice Court when I was a deputy clerk there.

Q. Yes, but now let's place the date on which you began this business of yours as public stenographer, preparing income tax returns, mimeographing, direct mail advertising, telephone answer-

(Testimony of Rose Goldstein.)

ing service, was it sometime between 1935 and 1940 that you began that business?

A. Well, I can't just recall what year it was, before I moved over into the Southern Hotel.

Q. You can't recall when you started the business, or you can't recall when you moved into the Southern Hotel, which is it?

A. You are asking me when I started my public stenographer business?

Q. Yes.

A. See, and I can't say whether it is between 1934 or '40, or the time I come to the Southern Hotel.

Q. And you came to the Southern Hotel in what year?

A. I think it was before 1942, or after Mr. Rau took over the Southern Hotel.

Q. Before 1942, or after he took over the Southern Hotel?

A. Well, it was before 1942, whenever he took over the Southern Hotel, it was either three or six months after that when I moved into the Southern Hotel lobby.

Q. Well, let me ask you the question this way: did you have this business at the time you moved into the Southern Hotel? A. Yes, sir. [509]

Q. You did? A. Yes, sir.

Q. Now, you had this particular business involving all of these different things in addition to that, you took on the task of keeping books and records of three different businesses involving hundreds of

(Testimony of Rose Goldstein.)

thousands a year, as you have testified to, for the sum of $10 a month, in addition to the many duties that you have related? A. Yes, sir.

Q. Would you please explain to the Court why you wanted to take on these extra burdens involving this much money which you have certainly testified to, for the sum of $10 a month, when you had a business of public stenography, direct mail advertising, telephone answering service, mimeographing, and preparation of Federal income tax returns; please explain to the Court why you took on these, this task here of all these records for $10 a month?

A. Because that didn't take much time to do.

Q. Oh, you didn't spend but very little time on it? A. Yes, sir.

Q. Devoted about how many hours a day to it?

A. I can't say.

Q. Well, you worked on them for years, '42, '43, '4, '5 and part of 1946; that is five years, you spend a lot of time on those records, I would assume.

A. Not when you make your daily records, when you take them and put them in your journal. Sometimes I would [510] work, maybe every day, sometimes maybe once a week on them.

Q. Now, Miss Goldstein, this is Exhibit U. Miss Goldstein, I show you Respondent's Exhibit U for identification, and ask you if that is the cash journal?

A. Yes, that is the cash check and cash journal.

(Testimony of Rose Goldstein.)

Q. The tabs that you see on the end of these sheets, French Cafe, January 1941, June 1946, Southern Wine and Liquor, June 1942, August 1947, is that in your handwriting? A. No, sir.

Q. Did you put those tabs on there?

A. No, sir.

Q. Who put the tabs on?

A. I don't know.

Q. Were they put—were they there when you picked up these records, when you first got them?

A. Only in the courtroom.

Q. Only in the courtroom?

A. Yes, in the courtroom here.

Q. Now, there is also another one, Southern Hotel January 1941 to September 1947, and you kept the records, and these were all in your handwriting? A. Yes, sir.

Q. Were there any other records that you kept for Mr. Rau, other than what I have shown you?

A. There was a cash book for the Southern Hotel, showing the room receipts.

The Court: We will reconvene at two o'clock.

(Whereupon, the hearing in the above-entitled case was recessed at 12:00 o'clock, until 2:00 o'clock p.m. the same day.) [511]

Afternoon Session—1:45 P.M.

ROSE GOLDSTEIN

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Cross-Examination
(Continued)

By Mr. Simpson:

Q. Miss Goldstein, I think when we were finishing up before noon recess, we discussed something about the date on which you informed the Internal Revenue Service of the falsification of information in the books and records that you maintain, as well as the income tax returns.

Would you please state again the name of the person to whom you conveyed that information?

A. Mr. Branas.

Q. How do you spell his last name?

A. Capital B-r-a-n-a-s.

Q. Do you know his first name?

A. No, I don't recall it right now.

Q. And he was in Bakersfield?

A. Yes, sir.

Q. Internal Revenue Service?

A. Yes, sir.

Q. Was he a revenue agent, do you know?

A. Yes, sir.

Q. Do you know where he is now?

A. I don't know if he still has his office in the Haberfelde Building or not, but that is where he did have it.

(Testimony of Rose Goldstein.)

Q. Is he still with the Internal Revenue Service? A. As far as I know. [512]

Q. Now, the month and the year in which you informed the Internal Revenue Service?

A. I am not—I don't recall what the month or the year, but it was between 1948 and 1949.

Q. What prompted you at that time to inform the Internal Revenue Service of the condition which you knew had prevailed for many years prior to that?

A. For the simple reason I know that it was being done wrongly, and that if I didn't report it they would think that I was in cahoots with Mr. Rau. And I wanted to protect myself.

Q. Could you not have done that by refusing to prepare the income tax return for 1942?

A. I was in Mr. Rau's employment at the time.

Q. But you had a separate business of your own?

A. Yes, sir.

Q. Therefore, please explain, if you will, why it is that if you did prepare a false return for 1942, knowing it to be false at the time you prepared it—— A. I don't know why I didn't.

Q. You don't know why you didn't do something about it then? A. Yes, sir.

Q. Well, can you state why you did not refuse to file or prepare a false return that you knew was false at that time?

A. I explained to Mr. Rau the conditions. He told me to go right ahead and not worry. [513]

Q. If Mr. Rau had told you anything else that

(Testimony of Rose Goldstein.)

was wrong, you would have done it because you were his employee? A. Naturally.

Q. Naturally. Now, you had this separate office which you were a public stenographer, Notary Public, direct mail advertising, telephone answering service, and other things. You were receiving $10 a month to keep the books and records for the Southern Wine and Liquor, Southern Hotel, French Cafe; what were you paid when you prepared Mr. Rau's income tax return for 1942?

A. No money for preparing any income tax.

Q. You were not paid for that?

A. No, sir.

Q. Were you paid for it in 1943?

A. No, sir.

Q. In 1944? A. No, sir.

Q. In 1945? A. No, sir.

Q. 1946? A. No, sir.

Q. Then the $10 that you received per month, not only covered the keeping of the books for these three different businesses, but also the preparation and filing of a Federal income tax return?

A. Yes, sir.

Q. You had a business of your own at that time?

A. Yes, sir, and—— [514]

[Clerk's Memo: Two pages numbered 514. Reporter's error in numbering.]

Q. You want to say anything else? All I want to know, you state you had that business at that time? A. Yes, sir.

Q. You did; thank you.

(Testimony of Rose Goldstein.)

Did you need this $10 a month to augment your income? A. No, sir.

Q. Would you care to state whether or not the keeping of books and records for three different businesses, preparation and filing of income tax return, calls for more salary than $10 a month?

A. I figured my desk space worth $100 or more, in the hotel lobby, which was a very good location, and gave me advertisement.

Q. Did you consider that as income your own income tax return?

A. I reported whatever I made.

Q. Well, the value of your office, do you consider that to be income to you?

A. Not exactly.

Q. Not exactly, consider that, but you consider yourself an expert bookkeeper?

A. No, not exactly.

Q. Do you consider yourself an expert in the preparation of income tax returns?

A. According to my understanding.

Q. You are an expert? A. No, I am not.

Q. For preparation of returns?

A. No, sir.

Q. You prepared returns for other people?

A. I did.

Q. Did you ever prepare an income tax return for Mr. Harry Jackson? A. I don't recall.

Q. Do you know whether or not Mr. Harry Jackson operated a tire business in Bakersfield?

(Testimony of Rose Goldstein.)

A. I remember of a Jackson Tire Company in Bakersfield.

Q. You do not recall whether or not you prepared a return then for Mr. Harry Jackson?

A. No, I can't recall it at this time.

Q. Do you know whether or not you were called upon at a subsequent date in connection with an income tax audit of a Mr. Harry Jackson?

A. No, I don't recall.

Q. Don't recall? A. No, sir.

Q. Now, coming down to the cash that was taken according to Mr. Webb's testimony, and your own, from the French Cafe, the Southern Wine and Liquor Bar, on those occasions when Mr. Webb was not in the hotel, what did you do with the money?

A. It was returned over to Mr. Walter R. Rau, Sr.

Q. Where was he?

A. In the hotel lobby in back of the desk [515] there.

Q. In the back of the desk is where you turned the money over to him?

A. Yes, sir, when he would be down there.

Q. And you handed him the cash?

A. He took the money and put it in the envelope in the back safe.

Q. Did you give him $10 and $25, or total of $35 on those days that Mr. Webb was not there, and hand the $35 to Mr. Rau, personally?

(Testimony of Rose Goldstein.)

A. I did not take it out of the cash; he took it, himself.

Q. Now, explain how Mr. Rau took the cash?

A. The cash was right there on the hotel desk, and he came out. I showed him the figures, the paper, he took the $10 out of the French Cafe, the $25 out of Southern Wine and Liquor.

Q. And you showed him what information?

A. From those cash sheets.

Q. The French Cafe? A. Yes, sir.

Q. And I will show you Exhibit 21, and ask you, January 2 is the date, here is a $10 figure subtracted from $516.99, leaving a figure of $506.99; that is correct, is it not?

A. According to the figures there.

Q. Now, there is an additional figure of $150 immediately below the $506.99. Now, is that the sheet that you exhibited to Mr. Rau at the time you handed him [516] the cash?

A. Not that date. If I wasn't working at that date, I couldn't.

Q. Well, only for purpose of illustrating the procedure that you followed on those occasions when Mr. Webb was away. A. Yes, sir.

Q. That is what you showed to Mr. Rau?

A. I did.

Q. These daily sheets of the French Cafe?

A. Yes, sir.

Q. You showed him the entries that were entered there on the bottom?

A. Before these entries was made, he took the

(Testimony of Rose Goldstein.)

$10. I put $10—he was the one who would take the amount of that $150 or whatever he wanted; then he would have me take, deduct it from the balance and that was the deposit.

Q. My question is, you showed him the $10 figure, if you wrote it down, and the $150 figure, if you wrote that down, that was made a record of how much was taken out?

A. He told me to take the $10 off, then he would tell me to take the $100 or whatever amount he wanted to take off, which I showed on that paper.

Q. And then you actually took a pencil and put the figures on that sheet?

A. Yes, while I was working.

Q. While you were working?

A. For Mr. Webb. [517]

Q. And you took that sheet on which you had already written the $10 figure, or $150 figure, as the case may be, and showed it to Mr. Rau?

A. I did.

Q. And then at the same time you handed him an equal amount of cash to correspond with the amount that was shown on that daily slip?

A. The $10, plus the $150, or $160, which he took out of that money, himself.

Q. So, you wrote the figures down on the French Cafe daily sheet, on those occasions?

A. Those sheets, I never put them in the book.

Q. I know, but what I am trying to get from you, you actually wrote the figure, yourself, in pencil on the daily sheet of the French Cafe?

(Testimony of Rose Goldstein.)

A. When I was working for Mr. Webb.

Q. When you were working for Mr. Webb.

A. When he was off. And I took his place, and Mr. Rau would be there before any transaction would be taken, any cash transaction would be taken off of the cash sheets.

Q. So then you, as well as Mr. Webb, wrote the figures on the daily sheets of the French Cafe?

A. According to Mr. Rau's orders.

Q. Now, just a minute. Did you, yourself, personally write the figure down on the daily sheet of the French Cafe?

A. Not without orders from Mr. Rau. [518]

Q. But you did it? A. Yes, sir.

Q. And then you showed it to him?

A. Mr. Rau was there first, before that money was taken, or put on those cash sheets. He was the one that told me to show the $10, plus the amount that was taken out on week ends.

Q. Would you please explain what you mean, he was there first?

A. He was down there at the office, when he came down, he wanted to know where the records and the receipts, I would take those out, show it to him right there, then he would tell me to take the $10 out of the cash, and whatever amount he wanted to take out on the larger amount.

Q. And then you made the note?

A. Then while he was still there, I deducted them off of this here.

(Testimony of Rose Goldstein.)

Q. He observed you writing down $10, subtracting it from the net proceeds of the receipts for that day, and then if there was $150, he saw you write down $150, and subtract that and keeping, in keeping a record of it? A. Yes, sir.

Q. Now, did he make any comment to you when he saw you keeping a report of the cheating?

A. No, he never made any comment.

Q. In other words, he saw you keeping the record of his cheating on his records?

A. Yes, sir. **[519]**

Q. You are a tax expert and a bookkeeper, and you were keeping a daily record of this man's cheating; isn't that correct now, Miss Goldstein?

A. When I first went over to the Southern Hotel, I wasn't doing much tax, income work, and then when I started to take Mr. Webb's job, those instructions were given me what to do. But when Mr. Webb was not there, and Mr. Rau came down, he told me about taking the $10 off, plus the amount that he wanted off on the larger amount.

Q. But now, I just want to have it for the record that you did show him the daily sheet explaining to him that day by day you were keeping a detailed account of his cheating?

A. I don't know what he did with that money.

Q. Well, didn't you prepare his income tax returns? A. Yes, sir.

Q. Well then, don't you know what he did with it?

(Testimony of Rose Goldstein.)

A. Not the money he took out of his pocket. He didn't turn it back into the businesses.

Q. Well, you knew he didn't report it as income, though, did you not?

A. I know it. I notified him of it.

Q. Well, didn't he already know it?

A. Yes, sir, he knew about it, but he continued, told me to continue on the way he had told me to do. [520]

Q. Well then, on these occasions when you talked to him, when you were, exhibited to him the income tax return that you prepared, and showed it to him, you told him again that it was wrong; is that it? A. I did.

Q. Well, didn't he already know that it was wrong?

A. Yes, but he just laughed and shrugged his shoulders.

Q. Please state why you had to tell him again, if it was wrong, if you already had told him, you already had informed him, as I understand your testimony, from these daily sheets, or a detailed accounting of this man's cheating and he was well aware of it, made no comment, and agreed that is the way it should be done; is that so?

A. That is the orders from Mr. Rau, Sr.

Q. And in 1942, his mind was very alert, I believe you stated? A. Yes, sir.

Q. And it was also true all the way through 1947? A. Yes, sir.

Q. Very alert. Now, you showed this man who

(Testimony of Rose Goldstein.)

has an alert mind these records of his cheating, and now I want to have it to establish it clearly that he made no comment? [521]

A. No, sir.

Q. When he saw it?

A. He knew what was going on, and he never made any more comment on it.

Q. Thank you. Now, he was downstairs in the hotel in the main lobby when you showed him the daily cash sheets of the French Cafe?

A. When he would come down from his room, downstairs, and he would always come into the hotel lobby, into the hotel behind the desk of the hotel lobby, where the office was, for the Southern Hotel.

Q. And that he did every day?

A. Yes, sir.

Q. And did you see him look at these sheets every day?

A. Well, when Mr. Webb was there, I had my own work to do. I wasn't paying any attention to that, only when I was there.

Q. So, only on those occasions that you were there, and Mr. Webb wasn't? A. Yes, sir.

Q. How far away was your desk space from the table on which these papers would be left?

A. From the Judge's desk, to about to the end of that fence there. [522]

Q. That is how far away your office was?

A. Yes, sir.

Q. You could see Mr. Rau, when you were at your desk every day when Mr. Webb was there, and

(Testimony of Rose Goldstein.)

you were taking care of your own business, you saw Mr. Rau come down and look over these daily sheets of the French Cafe?

A. I didn't say that I could see him do it. He would be there. What they were doing, I don't know.

Q. All right, thank you.

Now, did you ever take those daily sheets up to Mr. Rau's room in the hotel, upstairs?

A. I don't recall whether I did or whether Mr. Webb did.

Q. Can you state whether or not you ever did it, yourself, personally?

A. No, not to my knowledge.

Q. From whom did you receive the information to put down on the daily sheets of the French Cafe?

A. Both Mr. Webb and Mr. Rau.

Q. Miss Goldstein, when Mr. Webb was away, who handed you the daily cash sheets from the French Cafe?

A. From the steward or the manager of the French Cafe. Bring it in in a box.

Q. In a box? A. With the money. [523]

Q. With the money?

A. Of the receipts taken from the register for the day's receipts.

Q. Did they have a cash register tape?

A. Yes, sir. It was right there in the box.

Q. What did you do with the cash register tape?

A. Left it there until Mr. Rau came downstairs. I handed it to him with the cash sheet.

(Testimony of Rose Goldstein.)

Q. Now, you handed both the tapes and the daily cash sheets? A. Yes, sir.

Q. To Mr. Rau? A. Yes, sir.

Q. At the same time you handed him the cash?

A. It was in the cigar box there.

Q. Did you put it in the cigar box?

A. No, sir. It was handed to me from the French Cafe.

Q. In a cigar box? A. Yes, sir.

Q. Did you open the cigar box?

A. When Mr. Rau came down, that is when I opened it.

Q. Then did you take the cash out of the cigar box, and hand it personally to Mr. Rau? [524]

A. Took it out and counted it in front of Mr. Rau, show him what the balance was after the cash payouts. Then he told me to take the $10 off of that; then if it was on a Saturday or Sunday, or holiday, I was working, he would tell me the amount to take off of that balance.

Q. Now, let's get right down to the cash, itself, taken out of the cigar box, and did you hand it to Mr. Rau personally?

A. Hand what to Mr. Rau?

Q. The cash?

A. I gave it out, took the money out of the cigar box, put it on the counter, counted while Mr. Rau was there, less whatever the payout of the cash payouts was, and the balance of that he told me to take $10 out of that cash, then also whatever

(Testimony of Rose Goldstein.)

amount, if it was Saturday, Sunday or holiday, he was the one that told the amount to take out.

Q. What was done with the remaining cash?

A. That was put back in the box, and left there. When Mr. Webb come, he took care of that, made the deposits, entered it in the daily year book. I had nothing more to do with that.

Q. You left the cash in the cigar box?

A. Yes, sir.

Q. And when Mr. Webb returned, you presumed, but you didn't see him do it, you presume that Mr. Webb took [525] the cash out of the cigar box?

A. Whatever he does with it when he takes it out to make up the deposit.

Q. Did you ever make a deposit in the bank account for Mr. Rau, during Mr. Webb's absence?

A. I might have. I am not sure whether I did or I didn't. I might have done it while he was away on his vacation, which I would have to make the deposit slip up for him.

Q. You heard Mr. Webb testify that he was out for about a week or ten days, couldn't remember the year, maybe 1944 or 1945, something like that, he was in the Mercy Hospital. During that time, did you make the deposits for Mr. Webb?

A. According to——

Q. For Mr. Rau.

A. When Mr. Rau was there, when those deposit slips were made up——

Q. Did you make up the deposit slips for Mr. Rau?

(Testimony of Rose Goldstein.)

A. Yes, sir, I had to do it when he told me to.

Q. Where were those deposit slips kept?

A. The blank ones?

Q. The deposit——

A. They were kept right there where we kept the check books in the drawer, right in front of the hotel office. [526]

Q. Have you seen those deposit slips at any time since they were left at the hotel? A. No, sir.

Q. Did you have occasion to use those deposit slips at all in your bookkeeping? A. No, sir.

Q. If money was deposited to his bank account, what kind of a record did you make that day, when Mr. Webb was away?

A. Away, when he was sick or on his vacation?

Q. Yes. A. Or week ends?

Q. Either one.

A. Mr. Rau, I showed the book there, I kept all those slips until Mr. Webb come back from his vacation. I never put them in the book.

Q. Now, the books and records that you kept, where were they actually maintained in that hotel?

A. In the top drawer of the desk in the back office.

Q. But not in your office where you conducted your business? A. No, sir.

Q. Miss Goldstein, do you recall revenue agent Walter Slatter?

A. No, I don't recall. You know, I don't know their [527] names much.

(Testimony of Rose Goldstein.)

Q. Do you recall an examination of Mr. Rau's income tax returns for the years 1942, 1943, and 1944, in which there was an additional assessment made against Mr. Rau?

A. No. He might be, but I just don't recall it at this time.

Q. You don't recall it? A. No, sir.

Q. Did you ever go upstairs to Mr. Rau's room with Mr. Slatter?

A. If I did, I might have, but I don't recall. I might have gone up many times with different people up to Mr. Rau's room.

Q. You were the bookkeeper and you had the books? A. Yes, sir.

Q. Mr. Rau's income tax returns and it would show were audited by Mr. Walter Slatter. He filed a report.

Did he make that adjustment without your knowledge?

A. What do you mean, he made that adjustment without my knowledge?

Q. To increase Mr. Rau's income tax liability for those years?

A. If he was there, and he was up to see Mr. Rau, and told Mr. Rau, naturally, he must have.

Q. You don't recall Mr. Rau having to pay $20,000 [528] additional taxes?

A. I don't remember.

Q. Now, if he wrote a check to the Collector of Internal Revenue for $20,000, would you have made the entry in the journal? A. No.

(Testimony of Rose Goldstein.)

Q. Where would you make the entry, Miss Goldstein?

Mr. Gardner: If the Court please, if Counsel for Petitioner intends to introduce evidence at variance with anything she might say, I have no objection to this line of cross-examination; otherwise, there is nothing in the record relating to any prior investigation and this is going beyond the scope of the direct.

And I object to these questions on that ground.

The Court: What is the purpose of this line of inquiry, Mr. Simpson?

Mr. Simpson: The purpose is to determine the extent to which this witness assisted the revenue agent in determining the income for the years in which adjustment was made, for the years 1942, '3 and '4.

Counsel for Respondent has made the objection. I now call upon him to produce the report filed by Mr. Walter Slatter, Revenue Agent, on the assessment of this, showing payment of additional income taxes for the years 1942, 1943, and 1944. Then I can pursue this line of questioning, because [529] I have something very definite to establish. It is most important to this case.

The Court: Is this a report that was given to the taxpayer at the time?

Mr. Simpson: A statement of additional income taxes due. The original report, I presume, is on file with the Commissioner of Internal Revenue.

(Testimony of Rose Goldstein.)

The Court: Is there a copy of the report given to the taxpayer at the time?

Mr. Gardner: I believe it was, your Honor.

The Court: Have you seen it, Mr. Simpson?

Mr. Simpson: I have some correspondence indicating that there was a report submitted in connection with that. I have seen an entry made of $20,000 for 1942, '3 and '4, prepared by Mr. Walter Slatter. I have attempted to locate Mr. Slatter, and he is out of the city for this week.

The Court: I don't quite understand what the purpose of your line of inquiry is.

Mr. Simpson: The purpose is this——

The Court: With this witness.

Mr. Simpson: Yes. This witness had the books and records during that examination of 1942, '3 and '4, income tax liability, to which there was an assessment made, and paid by Mr. Rau. [530]

Now, she had the books and records, and consulted with Mr. Slatter. She must have at that time exhibited to him these sheets for the French Cafe, showing the system followed for those three years, for which he was conducting his examination.

The Court: You can follow that line of inquiry, whether you have the agent's report or not. How is the agent's report going to assist you in that?

Mr. Simpson: Because it would show the adjustments made to his income, and the basis for it.

The Court: Do you have a copy of the report, Mr. Gardner?

(Testimony of Rose Goldstein.)

Mr. Gardner: I have seen a copy of that report. I don't know if I have one here, your Honor.

The Court: If you have it, I suggest you make it available to Petitioner's Counsel.

Mr. Gardner: I have here what is apparently the original report of Walter J. Slatter, dated December 23, 1947, relating to tax liabilities for the years 1943 and 1944, as well as the year 1942.

Mr. Simpson: I would like to inquire of Counsel whether or not this is a complete report. I know it is customary that an agent will sometimes write a narrative, setting forth the persons with whom he has discussed these adjustments, and if there is any information in the possession [531] of the Commissioner, as to the persons with whom these adjustments were discussed.

I would like to have that, too, because it may show that they were discussed with this bookkeeper at the time he made his examination.

Mr. Gardner: If the Court please, he has in his hands now the copy that was furnished to the taxpayer at that time, and I would object very much to furnishing him with confidential information, or confidential report of the agent, any confidential communication he might make to his group chief.

If he wants to get the agent here, he can get him here and he can testify.

The Court: Were you handed at the time—will you hand Petitioner's Counsel a complete copy of the revenue agent's report that was delivered to the taxpayer?

(Testimony of Rose Goldstein.)

Mr. Gardner: That is my understanding, and that was my intention, your Honor, to give him everything that was given to the taxpayer.

The Court: Mr. Simpson, has that now in his hands.

Mr. Gardner: Yes, your Honor.

The Court: Proceed, Mr. Simpson.

Mr. Simpson: Do you want this Petitioner's Exhibit—would you mark this Petitioner's Exhibit marked for identification? [532]

The Clerk: Petitioner's Exhibit 27 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 27 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I want to show to you Petitioner's Exhibit 27 for identification, which is a report of adjustments made to Mr. Rau's income tax liabilities for the years 1942, 1943, and 1944. It has the name, Examining Officer, Walter Slatter, bearing date December 23, 1947; name of the taxpayer, Walter F. Rau, Sr., and ask you if that during the time that you were bookkeeper that you ever received a review or report submitted to Mr. Rau in connection with the adjustments to his income tax liabilities for these years, similar in nature, or identical, if you will, with this exhibit?

Now, take a look at that.

A. I don't recall this, and I don't know whether any money was paid to the Collector of Internal

(Testimony of Rose Goldstein.)

Revenue, because I wasn't with Mr. Rau in December of '47.

Mr. Simpson: If your Honor please, at this time, I would like to offer into evidence Petitioner's Exhibit 27, being the report of adjustment to Mr. Rau's income tax liability for 1942, 1943 and 1944.

The Court: For what purpose? [533]

Mr. Simpson: To establish that adjustment was made in the amounts and for the years as indicated in the report.

The Court: Made or proposed?

Mr. Simpson: Made.

The Court: What bearing does that have upon the issues before us?

Mr. Simpson: The bearing that it has, as far as we are concerned, is that the records which this witness has testified to, as well as Mr. Webb, will not coincide with the report made by the revenue agents at that time.

Otherwise, having these records, this adjustment could not have been made, your Honor. It must have included the figures that we see on these daily sheets of the French Cafe totaling much more, far more than the adjustments actually made.

I would like to establish that, perhaps.

The Court: It is on the assumption that the revenue agent made his audit upon the basis of those sheets, or that the sheets were available to him?

Mr. Simpson: Part of the records of the taxpayer, yes, your Honor, that is true. It must be

(Testimony of Rose Goldstein.)

assumed that he had performed his job, or his work in a proper manner, and that he did examine them.

The Court: You say so, but your statement that he did so isn't evidence. [534]

Mr. Simpson: But I assume when he made the examination it was done in the proper manner.

The Court: I can't make any such assumption at all, because if these sheets contain evidence of falsification, I can't assume for one moment that the taxpayer made such falsified sheets available to the—who was examining the matter. I can't make any such assumption as that.

I will admit your exhibit, if you can make anything out of it. I will let you try to do so, but I am stating now that it doesn't appear to prove anything to me at all.

Mr. Simpson: Well, in that connection then, certainly request permission to keep the record open until I can have Mr. Slatter in for purpose of taking his deposition, or having him in here, when he returns. No way for me to get him now, and then I can establish it, your Honor. It is very important to this petitioner's case.

We feel that a grave injustice may occur unless we are able to establish it.

Mr. Gardner: May I be heard, your Honor?

The Court: You may.

Mr. Gardner: This report to which we are referring now was prepared sometime ago. It has been known to petitioners for a long time. If they intended to have him here, intended to go into this

(Testimony of Rose Goldstein.)

matter, they could have had him for the trial now. [535]

I object to the introduction of this document, on the grounds that it is completely immaterial. There has been no showing here that it ties into anything in this case.

Further, the fact is that this revenue agent, former revenue agent, Slatter, could have been subpoenaed. This is not something new. This trial could continue indefinitely, and I object strongly to the record being kept open and left open to obtain the testimony of revenue agent Slatter.

Mr. Simpson: May I be heard now, your Honor?

Of course, I think it was natural for me to assume that this person who was a bookeeper, being present at the time this audit was being made, would have had knowledge of the fact that he was there, making the audit, and that these assessments had been made. I did not realize that she would say she doesn't remember.

The Court: I am not satisfied, Mr. Simpson, with the bona fides of your statement. If the agent saw these sheets, the agent was the man from whom to get that information. The notice of trial in this case was sent out, according to the records before me, on March 13 of this year, and the agent, himself, would be the most direct source to the evidence as to whether such sheets were made available to him. [536]

This witness testified that she was no longer working for Mr. Rau at the time this agent's re-

(Testimony of Rose Goldstein.)

port was prepared. At the very best, you could get only indirect evidence from this witness. The most direct evidence would be from the agent.

And there has got to be some kind of orderly conduct in the trial of the lawsuit. It is up to counsel to present their evidence and present it at the time the case is called for trial. If some new and unsuspected development had arisen during the course of the trial, that would justify keeping the record open.

I think if justice required it, I would keep it open, but in my judgment, no new and unsuspected development has occurred. In my judgment, the matter for which you ask me to keep the record open is a matter that plainly should have been anticipated at the time the case was being prepared for trial.

Deposition, at best, is not a satisfactory way of presenting evidence to a court. It has to be resorted to at times, because there is no better way of handling the matter. But the Court is now in session. It is prepared to receive such evidence as the parties have to present in the lawsuit.

I will not keep the record open beyond the period that the Court is in session in Los Angeles. Now, I do expect [537] this present session to last for some, at least for some three or four weeks beyond today, and I will keep the record open up to the end of this session, and if you can bring in the witness, bring in Mr. Slatter, or whatever his name

(Testimony of Rose Goldstein.)

is, during the period that the Court is in session, I will receive his testimony, but not beyond that.

Mr. Simpson: All right, your Honor. Thank you.

Only one observation, I question the good faith of my statement. I would like to say something in my regard.

Being a bookkeeper, I did assume, and I think rightly so, that she would have knowledge of this examination which I know was conducted prior to the time he submitted his report. It had to be in December of 1947, and for that reason, I assumed that this witness would be familiar with that audit and examination, and not believe at that time that she would not recall it.

And I honestly believe that she would have testified with respect to that audit, and I made those representations in good faith.

Q. (By Mr. Simpson): Now, Miss Goldstein, as far as you are concerned, you have no knowledge of an audit that was made by Mr. Slatter—get that in the record—while you were working for Mr. Rau? A. Yes, sir. [538]

Q. Mr. Slatter never discussed this with you?

A. I don't recall it.

Q. With respect to the cash, itself, you never saw Mr. Rau put the cash in his pocket that was taken off and put down on a table in the lobby?

A. Not to my knowledge, because I made a record on that slip of paper each day, and the amount held out and put it in his key, where he kept his key of his room. What he did with that,

(Testimony of Rose Goldstein.)

whether he put it in the envelope, or whether he put it in his pocket, I do not know.

Q. Then you do not know what happened to the cash after you saw him take it at the table?

A. No, sir.

Q. You have given considerable testimony and a great deal has been stipulated with respect to the manner in which purchases, cash purchases particularly, had been entered in the books and records.

You testified that you made those entries based on information given to you, particularly as it relates to the French Cafe on the daily sheets that you recorded that information.

You have also given testimony with respect to the automatic increasing of purchases for the years 1943, and 1944, on the face of the return.

Is it your testimony that Mr. Rau instructed you [539] to raise the purchases in that amount when you prepared the return? A. Yes, sir.

Q. In each case? A. Yes, sir.

Q. Each year? A. Yes, sir.

Q. You did that for 1944? A. Yes, sir.

Q. And for 1943? A. Yes, sir.

Q. Now, as a bookkeeper, what effect does that have on inventories at the end of each one of those years?

A. There was no inventory kept for the French Cafe, or the hotel, and inventory on the Southern Wine and Liquor. Whether inventory was on the Southern Wine and Liquor Company, Southern Wine and Liquor Company——

(Testimony of Rose Goldstein.)

Q. I don't believe I quite follow that answer. It doesn't make any difference on the Southern Wine and Liquor.

A. I said, no inventory was ever kept for the French Cafe, and there was inventory kept on the Southern Wine and Liquor.

Q. When you prepared the returns for each of the years 1942 to 1946, Mr. Rau came downstairs, did he, to the front desk, or did he go to your office, your desk space? [540]

A. No, he never came to my desk space at all.

Q. Well, he was at the office in the lobby?

A. Yes, sir.

Q. And Mr. Webb was there, and he saw the returns that were being prepared and signed by Mr. Rau?

A. When I presented them to Mr. Rau, for my records, for my books, Mr. Rau would check the figures. I told him the amount of tax he had to pay, and he said to raise the purchases, or any other expenses, so we wouldn't have that amount of tax to pay, or very little to pay.

And I did it on his orders, and I told him then, "Mr. Rau, pay the tax, but you will have to pay without raising your supplies and so forth."

Q. And Mr. Webb was there, and he heard the comments?

A. Mr. Webb was right there at the time, every time I brought those figures to Mr. Rau.

Q. He knew what went in the income tax returns each time? A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. Now, I think you testified that you devoted very little of your time to keeping of the books, making any audits, because you are devoting most of your time to your other business?

A. Yes, sir. The only book work I did was post the checks, which didn't take me long. I advised Mr. Rau [541] to have the books audited and he says, "No," to go ahead the way I had been doing.

Q. Well, did he have to have someone audit books when he had you?

A. Well, as a rule, people usually have their books audited even if they do have a bookkeeper.

Q. Were you not able to make the audit, yourself? A. I didn't want to.

Q. You didn't want to make the audit?

A. No. I would rather have an outside auditor to do it.

Q. So, each day that you saw these records coming in, knowing them to be false, you then put down those entries knowing them to be false, and recorded them as receipts?

A. According to Mr. Rau's instructions.

Q. And the same thing holds true with the income tax returns, themselves, when it came time to increase the purchases you did that, too, yourself, with your own pen or pencil?

A. On the orders of Mr. Rau.

Q. But you did it, yourself? A. Yes, sir.

Q. Then you signed those returns or at least one of them, I believe——

A. Here is one here, your Honor. [542]

(Testimony of Rose Goldstein.)

Q. Miss Goldstein, I show you Exhibit 3E, being the 1943 income tax return of Walter F. Rau, Sr., and ask if that is your signature as manager, or person who prepared the return? A. That is.

Q. Now, when you prepared that, and signed your name, you knew that it was false?

A. Yes, sir.

Q. And you were operating a separate business all of your own at that time, and deliberately, knowingly, knowing them to be false, signed it?

A. Yes, sir.

Q. Whenever there was anything that was wrong about the books and records that you kept, or about the income tax returns, you never failed to discuss it with Mr. Rau?

A. I did during the years from 1942 or '3, up until the time I was taking care of the books, I told Mr. Rau.

Q. And those discussions were held——

A. In the office of the Southern Hotel.

Q. Did anyone else hear those discussions, other than you or Mr. Webb?

A. Not that I know of. Because it wasn't for anybody else to hear.

Q. And it was a secret between you? [543]

A. Well, it wasn't exactly secret. I thought that was a personal matter between the employer and the employees.

Q. Now, it is true that you had your own separate business, prepared a return, you knew to be false, you signed it knowing it to be false.

(Testimony of Rose Goldstein.)

Did you work on Saturdays, Sundays and holidays? A. Yes, sir.

Q. Was your business open on Saturdays, Sundays and holidays?

A. Sometimes it was open on Saturday. After a while, Mr. Rau had told me to move down to the hotel, and gave me a room, so I would be closer to the hotel, and then when I would be up in my room, they would call me down for notary or for a letter to write, which I would come down, whether it be on Saturday, Sundays, evenings, holidays, I don't know.

And during income tax, I worked night and day.

Q. Well, for how long a period of time would that be? A. During the income tax time?

Q. That would be first of the year up to the 15th of March?

A. Yes, sir. And the last two weeks I wouldn't have any sleep at all, wouldn't even go up to my room at all. [544]

Q. And were you making entries in the books during the income tax time, when you were working night and day?

A. Sometimes I would, on Sunday, if it wasn't busy on my work. See, the first part of income tax isn't very rush. It is the last two weeks, or possibly the last week, when there is a rush on income tax.

Q. You go under the name of Miss Goldstein, but you are married, are you not?

A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. When were you married?

A. Married in July 22, 1942.

Q. Were you married in Bakersfield?

A. No. I was married in Pocatello, Idaho.

Q. What is your present married name?

A. Longway. L-o-n-g-w-a-y.

Q. Is that Mr. Jack Longway?

A. Yes, sir.

Q. Is Mr. Jack Longway, was he in the service prior to your marriage?

A. No, sir. He went in a month after we were married.

Q. A month after you were married?

A. Yes, sir.

Q. And then when did he leave the service?

A. 1945. [545]

Q. 1945? A. Yes, sir.

Q. Did you go into business with Mr. Longway after he came out of the service?

A. I still have my same business.

Q. You continued your separate business?

A. Yes, sir.

Q. Does your husband have a separate business apart from you?

A. Oh, after a year, or two, after he came back from the service.

Q. And what kind of business does he have?

A. That was a cafe business.

Q. Did he buy that business?

A. He got it for a small amount of money, as it was a rundown business, and he took it over.

(Testimony of Rose Goldstein.)

Q. Do you know how much it cost him?

A. I don't know. He handled that himself.

Q. Did it come a time when you and your husband bought a home?

A. After he come out of the service, we got a—he got a G. I. loan.

Q. Did you pay for it?

A. We were making monthly payments on it.

Q. How much did you pay down on the home? [546]

A. I can't recall that. He handled all that himself.

Q. What year did you buy your home?

A. I can't recall that either; might have been in 1946 or '47, I can't say.

Q. Can you state whether or not you made the down payment, yourself, at this time?

A. No, sir.

Q. Can you state whether or not your husband made that down payment?

A. I don't recall where the down payment was made, or when it was made; whether I was with him when it was made, or not, I can't say.

Q. What is the title that you have to the house, is it in your name?

A. It is in both our names, as joint tenants.

Q. Joint tenants? A. Yes, sir.

Q. If you paid for that, would you recall drawing a check to your account in payment for that home?

A. I had a savings account of all his money

(Testimony of Rose Goldstein.)

that he sent me on this, what they sent to the wives. I put it in a savings account. I also received some bonds from my uncle that died.

Q. How much did that amount to?

A. The amount of the bonds is $1,350. And it was [547] in my maiden name. I went to the Bank of America and I think Mr. Cash from the Bank of America, I think he was in that department at that time. I am not sure.

Q. When did you cash the bonds?

A. When my husband came home and he wanted to have some money. He needed for the business and the home, and he also had $5,000 worth of bonds, himself.

Q. He had $5,000 worth of bonds?

A. Yes, sir.

Q. Do you know when he bought them?

A. No, I do not. Because I was only married to him one month before he went into the service, so I didn't know anything of his personal affairs.

Q. And you bought your home, did you pay currency as a down payment, or did you issue a check?

A. I don't remember whether it was currency or whether it was out of the savings account, that money was taken, I can't recall. Been a long time ago.

Q. Other than your home, do you own any other property in and around Bakersfield?

A. Yes. We have a home on 30th Street.

Q. Except for your home, do you own anything else? A. Yes, sir. No, sir.

(Testimony of Rose Goldstein.)

Q. Do you own any unimproved lots?

A. The one next to the home we are at now. [548]

Q. How much did you pay for that?

A. $900.

Q. Do you know when you purchased it?

A. I can't recall that. It would be on record.

Q. Do you have an interest in any business in Bakersfield?

A. My husband has a wholesale business.

Q. What kind of a wholesale business?

A. Groceries.

Q. When did he get into that?

A. Well, while he still had the restaurant business, he went in partners with another fellow.

Q. Was he in one restaurant business, only one?

A. No, sir, he had two.

Q. He had two? A. Yes, sir.

Q. Do you know their names?

A. One was the Mellody Cafe on 99th Highway; the other was the Coffee Cup on 99th Highway.

Q. And also he had an interest in wholesale grocery? A. Tejon Wholesale Groceries.

Q. Tejon? A. T-e-j-o-n.

Q. Was any of the money used out of what you had saved for him to go into those three businesses? [549]

A. Yes, sir. Because I didn't have much expense at all, and I put that money in my savings.

Q. And then——

The Court: What money?

The Witness: What I would make in my busi-

(Testimony of Rose Goldstein.)

ness, and then my bond money, and the money he sent me while he was in the service, allotment checks, that is what it was.

Q. (By Mr. Simpson): What was his rating in the service?

A. When he went in, he went in as a third-class cook. When he came out, he came out commissary steward.

Q. Commissary steward? A. Yes, sir.

Q. Do you recall now approximately how much allotment checks would amount to per month?

A. Sometimes $40, sometimes $50 a month, all depends on how much he received.

Q. And for how many years was he in the service? A. From 1942 up till 1945.

Q. He was in for three years?

A. Approximately three years, or three and a half, I am not sure.

Q. He sent home approximately $480 a year?

A. He would, and then he would send me more home, outside of the allotment checks. [550]

Q. In addition to that, he was sending you more money? A. Yes, sir.

Q. I think, as a matter of simple arithmetic, he sent during that three year period $1440 to you?

A. He might have; yes, sir.

Q. Is it your testimony he also saved other money out of that so that when he came out of the service he had $5,000?

A. Out of what money?

Q. Out of what he received in his pay?

(Testimony of Rose Goldstein.)

A. Whatever money I put in the savings bank, I kept it there for him, which I felt was his money, not mine.

Q. But didn't you state, Miss Goldstein, that he had $5,000 of his own money?

A. $5,000 in bonds.

Q. That is his money, though?

A. Well, it was in bonds.

The Court: Was that in addition to what was in the savings bank?

The Witness: Yes, sir; yes, sir.

Q. (By Mr. Simpson): In addition to that?

A. Then he had a thousand or maybe $1100 currency when we got a safe deposit box. [551]

Q. Where is the safety deposit box?

A. At the Bank of America.

Q. Did you both have authority to go in that safety deposit box? A. Yes, sir, we did.

Q. I ask what did you keep in that safety deposit box?

A. Just insurance policies, and stubs of money that he sent home to his mother.

Q. Did you keep any cash in that safety deposit box?

A. Only that money I told you about.

Q. Miss Goldstein, can you state now approximately how much income you reported in 1946?

A. Not unless I have my records.

Q. Can you state how much you reported in 1947?

(Testimony of Rose Goldstein.)

A. I was in the hospital in '46. That is when my accident was, in '46.

Q. What accident was that Miss Goldstein?

A. In an elevator, went down, and I was in it and broke both my legs.

Q. In 1946? A. Yes, sir.

Q. What month was that? A. July. [552]

Q. July? A. 24, 1946.

Mr. Gardner: May I interrupt. I think we have some confusion here.

As I understood it, your elevator accident took place in 1956; is that correct?

The Witness: I beg your pardon, '56, yes. Excuse me.

Q. (By Mr. Simpson): In 1946, Miss Goldstein what was the income that you reported, approximately?

A. I couldn't recall now. I would have to see my records.

Q. Was it as much as $10,000?

A. I can't say.

Q. Have you ever reported during 1942 to 1947, as much income as $10,000 a year?

A. I can't say, unless I saw the records, how much I reported.

Q. You cannot recall how much you reported?

A. No, sir.

Q. On your own income tax return?

A. No, sir.

Q. Did you prepare your own return, Miss Goldstein? A. No, sir.

(Testimony of Rose Goldstein.)

Q. Who prepared it for you? [553]

A. I had Mr. Higby prepare it, and I had Mr. Ensign that worked for D. L. Pratt, and Mr. Pratt.

Q. Now then, you were a tax expert but you permitted, you had somebody else prepare your own returns? A. Yes, sir.

Q. Was that true for 1942?

A. I can't recall whether I did it or somebody else, outside those three.

Q. Did you ever prepare your own income tax return for any of the years from 1942 through 1947?

A. I would have to see the records on that.

Q. Isn't—you cannot recall whether or not you prepared your own return? A. No, sir.

Q. Further, it is your testimony that you do not remember how much you reported as income during any of those years, 1942 to 1947, inclusive?

A. Not unless I saw the records.

Q. Miss Goldstein, do you have a bank account?

A. Yes, sir.

Q. Where do you have it?

A. I have a checking account in the Bank of America.

Q. Is that your personal bank account?

A. I have a personal bank account. I have a business bank account, and I have for my rentals, a bank [554] account.

Q. Let's identify the years, specific, in 1942, did you have a personal bank account in the Bank of America?

(Testimony of Rose Goldstein.)

A. I don't remember when I first took out my checking account at the Bank of America. I don't remember when I started.

Q. Did you have one in 1943?

A. I don't remember that either.

Q. Did you have one in 1944?

A. I don't remember that either.

Q. Did you have one in 1945?

A. I don't remember that either.

Q. Did you have one in 1946?

A. I don't remember that either.

Q. Did you have one in 1947? A. I did.

Q. Did you have a personal bank account in 1947 in the Bank of America? A. Yes, sir.

Q. Did you have a business bank account?

A. Yes, sir.

Q. How do you distinguish between those two bank accounts?

A. My business would be Rose Goldstein, trustee, Rose Longway, agent, and my business—I mean, my business [555] would be Rose Goldstein, trustee; my personal would be Rose Goldstein, agent; and my rentals—I mean, Rose Longway, agent; and my rentals would be Rose Longway, trustee.

Q. You said them so fast, I couldn't quite follow you. Would the Rose Longway, agent, be the personal account? A. Yes, sir.

The Court: Off the record.

There will be a short recess.

(Short recess.)

(Testimony of Rose Goldstein.)

Mr. Simpson: Would you mark this, these sheets for identification as Petitioner's next in order?

The Clerk: Petitioner's Exhibit No. 28 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 28 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I show you Petitioner's Exhibit 28 for identification, being the bank acocunt that you testified to and name of Rose Longway, agent, Bank of America, and ask you to look at that, please, if you will? A. Yes.

Q. That is the bank statement for the calendar year 1947. Will you see, yourself, as to that, please?

A. Yes, sir.

Q. Now, I call your attention specifically to two deposits [556] in the amount of $1500 on August 8, 1947, and also to one of September 19, 1947, in the amount of $2,209.55, and ask if you can identify the source of those two deposits?

A. From my income tax service, where I draw it out of my business to put in that, or I divide so much of my business and so much of my personal, so I would have something to work on.

Q. This came from——

A. Income tax service.

Q. Income tax service? A. Yes, sir.

Q. You prepared returns during the tax period from January up to March 15 of the year?

A. In '47, we went to April 15.

Q. Well, these deposits are in, both in August

(Testimony of Rose Goldstein.)

and September. A. Yes, sir.

Q. Now, I ask you whether or not did you hold those receipts that you received for income tax service in April until September before you deposited them into your bank account?

A. Yes. I made duplicate deposit slips out of every deposit I made, and then when I drew out any money, I drew it out of my business and put it into my personal.

Q. These deposits were first put into your business [557] account?

A. Drawing out and put into my personal account.

Q. Into your personal account?

A. Yes, sir.

Q. Now, I call your attention to a deposit on March 29 of 1947, in the amount of $1,902.28, and ask if you can identify or explain the source of those funds?

A. The same thing, same amounts. Now, whether I put that amount in before putting it in my business, or just making a deposit to put to my personal account—that is the only way I would for any personal account, my personal account.

Q. So, a deposit that was made on March 29 of '47, you deposited directly to your personal account?

A. I think so. I am not sure whether I took it out of my business, and put in that, or whether I did it direct to my——

Q. May I call attention to deposit of March 4, 1947, amount of $500? A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. And ask if you can identify and explain the source of those funds? A. Yes, sir.

Mr. Simpson: If your Honor please, at this time, I would like to offer in evidence the bank statements just [558] identified by this witness.

Mr. Gardner: I would like to note an objection for the record, to the effect that this, at this point at least, the document desired to be introduced is immaterial on any issue in this case.

The Court: It will be admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 28 was received in evidence.)

Mr. Simpson: Please mark a group of 13 sheets as Petitioner's Exhibit for identification next in order.

The Clerk: Petitioner's Exhibit No. 29 marked for identification.

(The documents above referred to were marked Petitioner's Exhibit No. 29 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I show you Petitioner's Exhibit 29 for identification, in the—being bank statement of Rose Longway, your personal account in the Bank of America for the year 1946, would you examine that and satisfy yourself, that it covers the year 1946?

A. Yes, sir.

Q. Speak up so he can get it. A. Yes, sir.

(Testimony of Rose Goldstein.)

Q. Miss Goldstein, I call your attention to a deposit [559] in the amount of $3,642.88, on the date of January 31, 1946, in the personal banking account in the Bank of America, and ask you to explain the source of those funds, if you will?

A. That is also from income tax service.

Q. From income tax service? A. Yes, sir.

Q. You deposited directly to your personal account?

A. I can't recall whether I took it from my business and put it in that, or whether directly.

Q. I direct your attention to deposit on April 2, 1946, in the amount of $1,000, and ask you to explain the source of the funds for that deposit, if you will? A. Same thing.

Q. I direct your attention to the deposit on May 9, 1946, in the amount of $1,150, and ask you to explain the source of that, those, if you can?

A. Same thing.

Q. Directing your attention to the deposit in the amount of $800 on June 10, 1946, and ask you to explain the source of that? A. Same thing.

Q. From your business? A. Yes.

Q. Direct your attention to deposit on June 17, 1946, [560] in the amount of $400 and ask you to explain the source of that deposit?

A. Same thing.

Q. From the business? A. Yes, sir.

Q. From your business? A. Yes, sir.

Q. Direct your attention to deposit of $300 on August 6, 1946, and ask you to explain the source

(Testimony of Rose Goldstein.)

of that deposit? A. Same thing.

Q. Direct your attention to deposit of August 30, 1946, in the amount of $240, and ask you to explain the source of that deposit?

A. I would take, if I didn't deposit all my income tax to the business, I would put it to my personal.

Q. I ask you to look at deposit on September 16 in the amount of $512.79. A. Same thing.

Q. From your business? A. Yes, sir.

Q. Also on September 20, 1946, deposit in the amount of $600? A. Yes, sir.

Q. Also from your business? [561]

A. Yes, sir.

Q. Deposit on October 14, 1946, in the amount of $1,680, and ask you to explain the source of those funds? A. Same thing.

Mr. Simpson: If your Honor please, at this time I would like to offer in evidence the bank statements for the year 1946, just testified to by this witness.

Mr. Gardner: I would like to note for the record an objection to the introduction of this evidence, on the grounds that it is immaterial at this point.

The Court: Overruled. Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 29, was received in evidence.)

Mr. Simpson: Please mark the next sheets of eleven pages, as Petitioner's Exhibit next in order.

(Testimony of Rose Goldstein.)

The Clerk: Petitioner's Exhibit No. 30 for identification.

(The documents above referred to were marked Petitioner's Exhibit No. 30 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I hand you Petitioner's Exhibit 30 for identification, your bank account in your personal account in the Bank of America, for the year 1945, and ask [562] you to look at the sheets and satisfy yourself that it covers 1945? A. Yes, sir.

Q. It covers the year 1945? A. Yes, sir.

Q. I direct your attention to the deposit on May 17, 1945, in the amount of $604, and ask you to explain the source of the funds?

A. Well, I don't remember now whether I had a Rose Goldstein, trustee, for my business on that day. If I did, I took it from my income tax and transferred it to my personal; on all those others, the same thing.

Q. Is it your testimony then, Miss Goldstein, that the rest of the deposits appearing in this exhibit for the calendar year 1945, all came from your business? A. Yes, sir.

Mr. Simpson: If your Honor please, at this time I wish to offer in evidence Petitioner's Exhibit 30 for identification, identified by the witness.

Mr. Gardner: Note for the record an objection to this exhibit at this time, on the grounds it is immaterial.

(Testimony of Rose Goldstein.)

The Court: It is admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 30 was received in evidence.) [563]

Mr. Simpson: Please mark these 12 sheets as Petitioner's Exhibit next in order.

The Clerk: Petitioner's Exhibit 31 marked for identification.

(The documents above referred to were marked Petitioner's Exhibit No. 31 for identification.)

The Clerk: Petitioner's Exhibit No. 32 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 32 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I hand you Petitioner's Exhibit 31 for identification, being the personal bank account in the Bank of America for 1944, consisting of 12 sheets, and ask you to examine it and satisfy yourself that it covers the calendar year 1944?

A. The same procedure was done on that also.

Q. I direct your attention to deposit in the amount of $900 on July 11, 1944, and ask you if that was from your business? A. Yes, sir.

Q. Is it your testimony that the rest of the deposits appearing in this exhibit also came from your business? A. As far as I know, yes, sir.

(Testimony of Rose Goldstein.)

Mr. Simpson: If your Honor please, I offer in evidence [564] Petitioner's Exhibit 31 just testified to.

The Court: Admitted.

Mr. Gardner: I would like to note for the record the same objection to the previous exhibits.

The Court: The objection is overruled.

(The document heretofore marked for identification as Petitioner's Exhibit No. 31 was received in evidence.)

Q. (By Mr. Simpson): Miss Goldstein, I show you Petitioner's Exhibit 32 for identification, being your bank account in the Bank of America for the year 1943, and ask you to examine these 12 sheets, and satisfy yourself that they cover the year 1943?

A. It would be the same procedure.

Q. You are satisfied that they cover your personal bank account in the Bank of America for 1943, are you not? A. Yes, sir.

Q. I direct your attention to several deposits, first of which is $946.10 dated March 9, 1943.

A. That would be from my income tax, same with that.

Q. And deposit of $1297.23 on March 17?

A. Yes, sir.

Q. Deposit of $468.30 on March 15? [565]

A. Yes, sir.

Q. Deposit of $559.94 on September 23, 1943?

A. Yes, sir.

Mr. Simpson: Your Honor, I offer at the time

(Testimony of Rose Goldstein.)

Petitioner's Exhibit 32 just testified to by the witness.

Mr. Gardner: Same objection to this exhibit as previous, your Honor.

The Court: It will be admitted.

(The document heretofore marked Petitioner's Exhibit 32 for identification, was received in evidence.)

Q. (By Mr. Simpson): Miss Goldstein, you testified that your husband's name was Jack Longway?

A. Yes, sir.

Q. Was he ever a night clerk at the Southern Hotel? A. No, sir.

Q. Did he ever work at the Southern Hotel?

A. No, sir.

Q. Under the laws of the State of California, which is a community property law state, you have a vested interest in his bank account. I believe the Court can take judicial of that fact.

A. I had a what?

Q. A vested interest in your husband's bank account, [566] one-half of it belongs to you.

A. No, sir. He is the one that signs his own personal checks. I have nothing to do with it, if that is what you mean.

The Court: The Court realizes that California is a community property state. However, the Court also recognizes that in a community property state, there is such thing as separate property, and community property, and that there is a comprehensive

(Testimony of Rose Goldstein.)

set of laws to deal with what is community property and what is separate property.

Mr. Simpson: Miss Goldstein, then I am sorry. I didn't know whether you were through. Are you through?

The Court: Yes.

Q. (By Mr. Simpson): Miss Goldstein, are you familiar with the deposits that your husband has made in his personal bank account?

A. No, sir.

Q. Do you know where he maintains his personal bank account?

A. He used to have it—is it Security First National and the Bank of America.

Q. He had two bank accounts?

A. Before he transferred over to the Bank of America.

Q. And he had his personal bank account in the Bank [567] of America in Bakersfield, did he not?

A. Yes, sir.

Q. Did you ever make a deposit in his personal bank account?

A. He gave me the deposit slip with the money, and I, when I would make my deposit, I would deposit in his, and he would put it in his book, had nothing to do with mine.

Mr. Simpson: This is Petitioner's Exhibit next in order, consisting of 11 sheets.

The Clerk: Petitioner's Exhibit No. 33 marked for identification.

(Testimony of Rose Goldstein.)

(The document above referred to was marked Petitioner's Exhibit No. 33 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I show you Petitioner's Exhibit 33 for identification, being the bank account of Jack Longway in the Bank of America for 1946. I ask you to examine it.

A. Your Honor, I cannot. I don't know anything about my husband's bank account.

Q. Well, you made deposits in that bank account? A. Yes.

Q. And I want to ask you if you can identify some of these deposits. [568]

A. I cannot, because I don't know which ones I would deposit, or which ones he did.

Q. I direct your attention to deposit of March 15, see if I can refresh your recollection.

A. I don't know anything about it.

Q. $3,932.61, March 15, 1946, and ask if you can identify that deposit?

A. I can't; I can't identify any deposits.

Mr. Gardner: If the Court please, I am going to object to this line of questioning, regarding this document which relates to the bank account of one Jack Longway. We have had no identification of the statements, the document from which he is questioning, and further than that, the entire line of questioning is immaterial as to any issue involved in this case.

The Court: Counsel may interrogate.

Q. (By Mr. Simpson): Miss Goldstein, I want

(Testimony of Rose Goldstein.)

you to look at this bank statement, perhaps you can refresh your recollection.

There is a deposit $500 on March 7, 1946, are you able to identify that deposit?

A. No, I can't identify any of those deposits.

Q. Are you able to identify deposit of $500 on April 2? A. No, I cannot; no, sir. [569]

Q. Perhaps you can identify the deposit of $500 on July 2, 1946? A. No, sir.

Q. Are you able to identify deposit of $300 on July 6, 1946? A. No, sir.

Q. Can you identify deposit of $300 on July 15, 1946? A. No, sir.

Q. Are you able to identify the deposit of $400 on July 19? A. No, sir.

Q. You cannot identify any of the deposits in this account?

A. No, sir; no, sir, because I don't remember what deposits I did, which I made very few for him.

Mr. Simpson: If your Honor please, at this time I offer in evidence Petitioner's Exhibit 33 just testified to by the witness.

Mr. Gardner: If the Court please, I object to the introduction of this document. All it does is clutter up this record. We don't know whether that account represents a business account, a personal account. There has been no identification as to that account.

The witness was unable to identify it, and as it stands [570] now, it is just something sticking up here in space in orbit.

(Testimony of Rose Goldstein.)

The Court: Unless it can be tied into this case, more clearly than it has been up to this point, I regard it as inadmissible. You may reoffer it at a later time, if you have further foundation upon which to present it.

Mr. Simpson: If your Honor please, I believe that the foundation has been laid by Respondent, if you may hear me out, in that there has been considerable testimony here by the bookkeeper, Miss Goldstein, the present witness, as well as by the manager, Mr. Webb, to the effect that—and this is the basic theory under which the Government is directing its case—that there was a great, a large sum of money withheld in the form of cash.

This witness has testified that she has handled large sums of cash during Mr. Webb's absence, particularly on Saturdays, Sundays, and holidays, when there was as much as $150 a day withheld.

Now, the last person known to the Petitioner to be this witness, or perhaps Mr. Webb, himself, and in order to trace the final resting place of the money which they said was withheld from the French Cafe, and Southern Wine and Liquor, the burden has been placed upon the Petitioner.

I would assume under that theory to disprove that [571] the Petitioner, himself, retained the funds; in order to refute that I think it has a legal and logical relevancy to the testimony already elicited by the Respondent's counsel from this witness, as well as from Mr. Webb.

Mr. Gardner: May I answer, your Honor?

(Testimony of Rose Goldstein.)

Relating to the moneys that are alleged to have gone to the Petitioner's decedent, Mr. Rau, there is in the stipulation of net worth, this net worth will show substantial understatements in each of the years '42, '43, '44 and '45; this money at least stuck to his fingers, because we have agreed to it.

Now, that is the quantity and the amount there; we allege further, of course, that the deficiency depends upon the specific item adjustment, but is supported, strongly corroborated by the net worth statement agreed to.

So, whether or not this witness got $10—assuming she did—and I don't believe it for a minute, but assuming she did get $10, that has nothing whatever to do with the income tax deficiencies being set up against Mr. Rau.

The Court: If any of the funds were diverted to this witness, I would think that that would have a bearing upon this case, and if counsel for Petitioner has any proper evidence to show that there has been any such diversion, I would admit such evidence. [572]

I am not admitting this exhibit, because I believe that it is too remote and that there has not been laid a sufficient foundation to show the circumstances of the evidence that has been presented thus far, that they, that this represents any diversion of funds to this Petitioner of Mr. Rau's moneys.

Mr. Simpson: May I be heard, your Honor?

I believe that the record will ultimately show, perhaps I may be able to tie this evidence in with

(Testimony of Rose Goldstein.)

that—I believe I should be given the opportunity to do so, in this respect, that the amounts that these witnesses had testified to, which are in excess of the amounts that now appear by way of the stipulated net worth, will, when considered in the light of all the evidence that can be adduced here, corresponds and almost, I would say approximate that which has been testified to as not being reported.

Now, if in the event I am unable to prove that, then I believe that the evidence should be stricken, and that I believe is right. But if I can tie in their testimony with their own personal and private affairs, as we have done with Mr. Rau, the Petitioner, then I think that I have tied in my evidence with theirs.

I would like to be permitted to pursue that, be permitted, admitted additionally if the amounts I have shown [573] her do approximate the amounts which they say was not reported. Stricken, if not.

Mr. Gardner: I have no objection to him tying it up with proper evidence. This I do not believe is proper evidence, and I reiterate my objection.

The Court: Are there any deposits appearing upon the proposed exhibits in addition to the ones that you have interrogated the witness, that you wish to rely upon?

Mr. Simpson: I don't believe I will state this for the record. I will, after I approach the bench.

The Court: You may state it for the record.

Mr. Simpson: There is another deposit of another employee who is absent.

(Testimony of Rose Goldstein.)

The Court: I am talking about this exhibit.

Mr. Simpson: This exhibit, yes, I have two more years in connection with this particular exhibit, years 19——

The Court: I am talking about this exhibit, it is not about other papers.

Mr. Simpson: No. This is the only deposits that I have in connection with this.

The Court: Are the ones that you interrogated the witness about; you interrogated the witness about?

Mr. Simpson: Deposit on the——

The Court: About specific deposits appearing on Exhibit 33 [574] for identification, are there any other deposits on Exhibit 33 for identification that you rely upon, apart from the ones that you inquired of the witness?

Mr. Simpson: Yes. I rely on all the deposits in that exhibit.

The Court: I regard this exhibit as very remote. The testimony has been that Mr. Longway, himself, was in business of one sort or another. He had affairs of his own, apart from this witness. The deposits are quite inconclusive.

Nevertheless, out of an abundance of caution, I will reverse my ruling and admit this exhibit for whatever it may be worth, and I will give Petitioner's counsel the opporutnity to tie these particular figures in. If he does not tie them into this case, they will obviously be of no bearing upon the Court's decision to be rendered herein.

(Testimony of Rose Goldstein.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 33, was received in evidence.)

Mr. Simpson: Mark these 12 sheets as Petitioner's Exhibit for identification next in order.

The Clerk: Petitioner's Exhibit No. 34 marked for identification.

(The documents above referred to were marked Petitioner's Exhibit No. 34 for identification.) [575]

Q. (By Mr. Simpson): Miss Goldstein, I hand you Petitioner's Exhibit 34 for identification, being the personal bank account of Jack Longway in the Bank of America for the year 1947, and ask you to examine it and see if you can determine whether or not you made any deposits that you referred to, that were made for your husband in that year?

A. I cannot testify to it.

Q. Do you know whether or not you made any deposits in here? A. No, sir.

Q. Did you make any or do you know?

A. I don't recall making any deposit for Mr. Longway. He took care of that all himself.

Mr. Simpson: If your Honor please, I offer into evidence Petitioner's Exhibit 34, identified by the witness, testified to by the witness.

Mr. Gardner: Same objection as to the previous document, your Honor.

(Testimony of Rose Goldstein.)

The Court: This one is even weaker than the previous one, since the witness cannot testify that she made any deposits during this year on behalf of her husband.

Nevertheless, I will admit it for the purpose of giving Petitioner's counsel the opportunity of tying it into this case. If he fails to do so, it will have no [576] effect upon the court's decision.

(The document heretofore marked for identification as Petitioner's Exhibit No. 34 was received in evidence.)

Mr. Gardner: Very well.

Mr. Simpson: Nine sheets as Petitioner's Exhibit next for identification, next in order.

The Clerk: Petitioner's Exhibit No. 35 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 35 for identification.)

Q. (By Mr. Simpson): Miss Goldstein, I hand you Petitioner's Exhibit No. 35 for identification in the personal bank account of Jack Longway, your husband, for the year 1945, and ask you to examine this exhibit and state whether or not you can identify any of those deposits as having been made by you? A. I cannot.

Q. I wish to call your attention to, specifically, to deposit of $4,700 on December 15, 1945.

A. I don't know of any, whether I have nothing to do with his deposits or his checking account.

(Testimony of Rose Goldstein.)

Mr. Simpson: Your Honor, I offer in evidence at this time Petitioner's Exhibit 35, just testified to by this [577] witness.

Mr. Gardner: Same objection as to the previous exhibit, your Honor.

The Court: I will admit it but I regard it as subject to the same infirmities that I indicated with respect to the preceding exhibit.

(The document heretofore marked for identification as Petitioner's Exhibit No. 35, was received in evidence.)

Mr. Simpson: Excuse me a minute, your Honor.

Q. (By Mr. Simpson): Miss Goldstein, have you ever operated a business with your husband?

A. What do you mean?

Q. To be more specific, have you operated or obtained a certificate of business from the officials of the City of Bakersfield?

A. My husband did.

Q. Did you?

A. No, sir, to my knowledge.

Q. Still a little bit more specific then, perhaps, do you have an interest in the Tejon Wholesale Grocers?

A. It is my husband's business. Naturally I am his wife, there would be an interest for the both of us.

Q. What I would like to find out from you, Miss Goldstein, is do you operate that business with your

(Testimony of Rose Goldstein.)

husband [578] as a partner? A. No, sir.

Q. In what capacity do you operate the business with your husband?

A. I took care of the books there, doing the posting up until the time of my accident. Then I haven't touched them since.

Q. At the time of your accident, when was that, 1956? A. '56, yes.

Q. Well, did you have an interest with your husband in a business known as the Tejon Grocers before 1956?

A. I didn't have an interest in it. He was the one that was operating it.

Q. Did you file a certificate of business under a fictitious name for operating that business?

A. He must have; it would be on record.

Q. Did you sign it with him?

A. I don't recall.

Mr. Simpson: May I have a moment, your Honor?

Q. (By Mr. Simpson): Miss Goldstein, did you ever buy an interest in a business with your husband? A. No, sir.

Q. At any time? [579] A. No, sir.

Mr. Simpson: I have no further questions, your Honor.

(Testimony of Rose Goldstein.)

Redirect Examination

By Mr. Gardner:

Q. Miss Goldstein, referring to the questions asked you by Petitioner's counsel, relating to the deposits to the bank account of Rose Longway, agent, that is Exhibits 28, 29, 30, 31 and 32, I believe you testified that that was from your—that the deposits came from your income tax; is that right?

A. Income tax, or other business income.

Q. Yes. Now, what other businesses did you have?

A. Well, my Notary, did mimeographing, or any money that I received so much on accounts that I was supposed to take care of.

Q. You had income from your work as a stenographer? A. Yes, sir.

Q. A public stenographer, too, did you not?

A. Yes, sir.

Q. Now, there was one other point mentioned, I believe you stated in answer to questions by Petitioner's counsel, Mr. Simpson, that the French Cafe had no inventories; do you recall that, Mrs. Goldstein?

A. Up until the time I advised Mr. Rau he better show an inventory, which he did for two years, and after that he dropped it. [580]

Q. What two years was that, Mrs. Goldstein?

A. I don't recall whether it was—unless I saw the records.

(Testimony of Rose Goldstein.)

Q. I hand you Exhibit 3E, the 1943 income tax return of Walter F. Rau, and turning to the schedule therein relating to the French Cafe, do you see an item marked inventory in that year?

A. Yes, sir.

Q. That is one of the years that you did set up an inventory; is that correct? A. Yes, sir.

Q. Where did you get the figures that you used there, Mrs. Goldstein?

A. Mr. Rau told me to take that. He would put in a figure of $3500. He said with that that would consist of inventory at the beginning of the year.

Q. All right. You had no other verification of that? A. No, sir.

Q. Did he tell you the inventory to use at the end of the year? A. Yes, sir.

Q. Now, referring to Exhibit 4F, the income tax return of 1944 for Walter F. Rau, Sr., and turning to the schedule therein relating to the French Cafe, do you see any [581] inventory in that year?

A. No, sir.

Q. You did not use an inventory then that year, did you? A. No, sir.

Q. Referring to Exhibit 2D, the income tax return of Walter F. Rau for the year 1942, and turning to the schedule showing income from the French Cafe, did you find any inventory in that year?

A. No, sir.

Q. Then the inventories that you did set up in the income tax returns, when you set up, were set up at the insistence of Mr. Rau?

(Testimony of Rose Goldstein.)

A. I don't just get that.

Q. When you did set up an inventory like in the year 1943—— A. Yes.

Q. ——Mr. Rau told you what figure to put it; is that correct?

A. He was the one that gave me the figures.

Q. He is the one that gave you the figures?

A. Yes, sir.

Q. That is the only reason you included them in the income tax return? A. Yes, sir. [582]

Q. You didn't keep a regular inventory, did you? A. No, sir.

Mr. Gardner: No further questions, your Honor.

Mr. Simpson: No questions.

(Witness excused.)

Mr. Gardner: At this time I would like to offer in evidence Exhibit U.

Is there any objection, Mr. Simpson?

Mr. Simpson: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Respondent's Exhibit U was received in evidence.)

Mr. Gardner: I would like to inquire as to whether or not all of Respondent's exhibits marked for identification are in evidence?

The Court: Mr. Clerk, can you help us out?

The Clerk: Yes, your Honor. They are all in evidence, all that have been marked.

Mr. Gardner: Respondent has no further witnesses, your Honor.

Mr. Simpson: I would like to call as my next witness Betty Dorsey. [583]

BETTY DORSEY

a witness called by and in behalf of the Petitioner herein, having been first duly sworn, was examined and testified as follows:

The Clerk: Would you be seated and state your name and your address, please?

The Witness: Betty Dorsey.

The Clerk: A little louder, please.

The Witness: Just a minute, till I get my breath.

The Clerk: All right.

The Witness: Betty Dorsey. 1107 Virginia Street, Bakersfield, California.

The Clerk: Thank you.

Direct Examination

By Mr. Simpson:

Q. You have stated your name and address, Miss Dorsey. Will you please state the—your business or occupation, please?

A. Well, I take care of sick and have been for good number of years.

And some people would say a housekeeper, but I say I am a practical nurse. The doctor says a practical nurse.

(Testimony of Betty Dorsey.)

Q. Practical nurse. Have you been a practical nurse in Bakersfield for a number of years? [584]

A. Yes, I have, sir.

Q. Miss Dorsey, I ask you whether or not the occasion ever arose when you were employed by Mr. Walter F. Rau, Sr., was a nurse for him?

A. That was the occupation I was supposed to be employed by.

Q. And were you employed by Mr. Walter F. Rau, Sr., as his nurse? A. Yes, sir.

Q. And can you place the year in which you began working for Mr. Rau?

A. I am going to be truthful about it. It was, I think in the latter part of '45, that I started to work, but what month I cannot tell you.

Q. But your recollection is around in the latter part of '45? A. Yes.

Q. Now, when you first went to work for Mr. Rau, would you please explain the circumstances, how it was that you did go to work for Mr. Rau, who called you?

A. Well, I don't know who called the rooming house where I was rooming, but when I came in on my day off from where I was working, the landlady said that Mr. Webb had been trying——

Q. Mr. Webb? [585]

A. From the Southern Hotel.

Mr. Gardner: If the Court please, I can't hear this witness.

The Court: Would you speak up, Miss Dorsey?

(Testimony of Betty Dorsey.)

The Witness: I am trying to speak up, your Honor. I am sorry.

Mr. Gardner: Thank you very much.

The Witness: When I came in on my day off, where I was rooming, the lady said a Mr. Webb from the Southern Hotel was trying to contact me.

Q. (By Mr. Simpson): Did he contact you?

A. No, he did not contact me at the rooming house, because I got ready and went up to the hotel.

Q. Who did you see when you came to the hotel?

A. I saw Mr. Webb.

Q. And what did he say to you?

A. I asked Mr. Webb what was wanted of me, and he said Mr. Rau wanted to see me, and—excuse me a minute—and I said, "Mr. Rau, what's the matter?" And he said, "Well, he is ill."

Q. That is fine. Now, he said that he was ill. Did you at that time then go up to see Mr. Rau on that occasion? A. Yes, I did. [586]

Q. And was Mr. Rau in bed?

A. Well, Mr. Rau was sitting on the—Mr. Rau was sitting on the side of the bed. He was so large he was just sitting on the side of the bed. I don't think he would walk from the way—in fact, I know he couldn't walk.

Q. Now, you did have an opportunity to—strike that. I will phrase it this way.

When you began your employment as a practical nurse for Mr. Rau, did you stay at the hotel where he was? A. Yes, sir.

(Testimony of Betty Dorsey.)

Q. Did you have a room next to his when you began working for him?

A. He had a suite of rooms there, of two.

Q. Two?

A. And at that time when I first started to work——

Q. Did you occupy the room adjoining his?

A. My—mine was the front room on the couch.

Q. You worked 24 hours a day, so to speak?

A. I was there 24 hours a day; yes, sir.

Q. You began your employment, as you recall, the latter part of 1945; did you remain with him up until the day of his death?

A. I certainly did; yes, sir.

Q. You did. Now, did you observe Mr. Rau's use of alcohol while you were working for him? [587]

A. Well, that was the trouble; yes, he was quite——

Q. He drank quite a bit, did he?

A. Yes, sir.

Q. And would you say that he was intoxicated or at least under the influence of alcohol most of the day that you attended him?

A. Yes, he drank quite some.

Q. Yes. Now, did you endeavor to wean him away from the use of alcohol to such excess, try to reduce the amount that he consumed?

A. I would try to govern it to the best of my ability.

Q. Now, the state of his physical health at that

(Testimony of Betty Dorsey.)

time, would you say was rather poor; did he have difficulty in getting around?

A. Well, he went to bed. He was in bed, couldn't get around when I first went to working for him.

Q. I see. Now, during the time that he was up in his room, did anyone bring any books and records up to him, and show them to him while you were there with Mr. Rau?

A. Not to my knowledge; no, sir.

Q. Not to your knowledge, you never saw anybody bring any books or records, or any cash register tapes up in the room and show them to Mr. Rau?

A. No, sir, not while I was in the room. [588]

Q. Did you ever see Mr. Rau examine and go through any books and records of his business?

A. No, sir.

Q. Do you know Mr. Robert Webb?

A. Yes, sir.

Q. What was his position at the Southern Hotel, if you know?

A. Well, I understood his position at the Southern Hotel was manager.

Q. Manager? A. Yes, sir.

Q. And did you observe the extent of his activities in the management, were they quite evident, prominent, that he was taking care of Mr. Rau's business for him, running the business I should say?

A. Well, someone had to run it, because Mr. Rau wasn't able to go down. So, I presume Mr. Webb was running it.

Q. Now, in connection with Mr. Rau's mental

(Testimony of Betty Dorsey.)

condition, as a lay person, would you say that Mr. Rau was mentally alert and sharp, keen minded?

A. Not at all times.

Q. Not at all times. Would you then say that he was rather unresponsive or even slow mentally?

Perhaps I can rephrase that question and put it to [589] you this way: in your observation of Mr. Rau, in the way he talked or responded to anything that you might say, or question raised, was he quick and alert? A. No, sir.

Q. Were his answers? A. No, sir.

Q. He was not? A. No, sir.

Q. Were there any occasions during which Mr. Rau would often weap or cry?

A. Well, if company would come, yes.

Q. If company would come?

A. Or lots of times when he would get to talking, he would cry.

The Court: What period of time are you now referring to?

The Witness: That is during when I first started to work. In fact, that continued on till he died.

The Court: Throughout 1946 and 1947?

A. Yes.

The Court: Or was this a condition that was prevalent only near the end of his life?

The Witness: No, that was during '45. In fact, from the first, when I first began to work for him.

Q. (By Mr. Simpson): [590] Now, Mrs. Dorsey, did you make close—no, strike that.

(Testimony of Betty Dorsey.)

Did you clean and straighten the rooms that were occupied by you and Mr. Rau?

A. Yes, sir, I did.

Q. Did you also send out Mr. Rau's personal clothing to the cleaners?

A. Yes. His clothes went to the laundry and his personal clothes would go to the cleaners.

Q. Did you empty his pockets of his clothes before you sent them to the laundry or to the cleaner?

A. Well, if there was anything in the pockets, I would have to take them out.

Q. You would have to take them out. On those occasions that you were doing that, did you ever remove any large sums of cash?

A. No, sir, that I did not.

The Court: Did he dress every day?

The Witness: No. When I first went to working for him, your Honor, he couldn't—in fact, I had to make clothes, he was so large, he was 56 inches and around, and so big that I couldn't put any—he couldn't, he had to make pajamas to cover him, you know. And he couldn't dress himself. He never did dress himself from the day I went to work for him until—— [591]

The Court: Was he dressed on most occasions?

The Witness: After about three weeks, he would be dressed and then he would come up and lay down with his clothes on.

The Court: Did he ever leave the room at the end of that three week period?

(Testimony of Betty Dorsey.)

The Witness: Well, at first I wheeled him in a wheel chair downstairs.

The Court: He did go downstairs?

The Witness: I would take him and put him in the wheel chair, and put him in the elevator and take him down in a wheel chair. Then I would let him sit there and I would go upstairs and straighten things up. Then about that time he would be ready to come up again.

The Court: And did that practice continue every day?

The Witness: I just don't understand you, sir.

The Court: Well, did he continue to go down every day in the wheel chair?

The Witness: Well, he didn't stay in the wheel chair very long. He was out of the wheel chair.

The Court: And walking around?

The Witness: And then——

The Court: Was he walking around?

The Witness: I would help him and teach him to get him walking, so he could straighten his legs to walk. Then [592] he would go downstairs by himself and back up.

The Court: Without a wheel chair?

The Witness: Yes, sir. But he wouldn't stay downstairs. He would go down and come back up.

Q. (By Mr. Simpson): As far as Mr. Rau's personal needs are concerned, were they, would you say they were very simple and unextravagant; he didn't require a great deal, did he, Mrs. Dorsey, very simple needs, himself, personally?

(Testimony of Betty Dorsey.)

A. No, he didn't require—you had to keep him clean.

Q. Yes. But I mean, his personal needs.

A. No.

Q. He wasn't extravagant, spend a lot of money, there were very simple needs? A. Yes.

Q. Now, this cleaning the room, did you ever discover any large amounts of cash or currency in his room? A. No, sir.

Q. Did you ever see any books and records around in his room?

A. No, sir; no, sir, that I did not.

Q. Now, did you go downstairs with him on some occasions when he went down in the lobby? [593]

A. Yes. I went.

Q. On those occasions, did you ever see him make any entries in any books in your presence?

A. No, because I wouldn't stay with him.

Q. Do you know Miss Rose Goldstein?

A. Yes, sir, I do.

Q. Do you know whether or not, from your own personal knowledge, while you were there, that she took an active part in the management of this business with Mr. Webb?

A. The only thing I can say to that is I took care of Mr. Rau, and as far as business is concerned, I paid no attention.

Q. You paid no real attention to that.

I have no further questions.

(Testimony of Betty Dorsey.)

Cross-Examination

By Mr. Gardner:

Q. Miss Dorsey, is it Miss or Mrs.?

A. Mrs. Dorsey.

Q. Mrs.? A. Yes, sir.

Q. Mrs. Dorsey, I believe you stated you were employed first by Mr. Rau in 1945; is that correct?

A. I think it was in the latter part of '45.

Q. In the latter part of '45? A. Yes. [594]

Q. And from the time that you were first employed by Mr. Rau, in the latter part of 1945, you stayed with him continuously up until the time he died; is that right? A. Yes, sir.

Q. Now, by staying with him continuously, do you mean that you were with him 24 hours a day?

A. Yes, sir.

Q. Twenty-four hours a day?

A. Yes, sir.

Q. Well now, I believe you testified that there were occasions when he would go downstairs in 1945 and you would be upstairs cleaning the room, you weren't with him continuously, were you?

A. Well, I was. I don't know what else, I was in the hotel that would, of course—of course, I wasn't by his side.

Q. You weren't by his side? A. Yes.

Q. In other words, he was doing what he wanted to do and you were doing what you wanted to do during the day? A. Yes.

(Testimony of Betty Dorsey.)

Q. When you first went there, as I understand it, he was rather ill at that time; is that right?

A. Very ill. [595]

Q. And what was his trouble?

A. Well, alcohol and no eats.

Q. Alcohol and no what?

A. And he wouldn't eat when he was drinking.

Q. And he wouldn't eat. Now, how long did it take you to clear up this condition?

Mr. Simpson: If your Honor please, I don't think there is any testimony on direct examination that she cleared up that condition.

Mr. Gardner: I believe she has testified that she tried to get him to quit drinking and there was testimony that, to that effect, Mr. Simpson.

The Witness: I don't know, it was all the time that I was with him, I would try and govern liquor.

Q. (By Mr. Gardner): How long was he sick in bed, Mrs. Dorsey?

A. That I cannot tell truthfully. You know what I mean, I can't tell you exactly, but I think it was three weeks.

Q. Three? A. Three weeks.

Q. Three weeks he remained in bed?

A. When he had to.

Q. How did he get his liquor when he was in bed, and you were with him all the time? [596]

A. I would have to go out and shop. He would use the phone and call up and get it.

Q. He would use the phone and call up and get it? A. Yes, phone was by his bed.

(Testimony of Betty Dorsey.)

Q. Phone was by his bed. Now, while you were out—by the way, how long did you go out and shop every day? A. Whatever time it took me.

Q. I didn't understand you.

A. Whatever time it took me.

Q. What time would it take?

A. I couldn't tell you that.

Q. Four hours?

A. Oh, no, wouldn't take me four hours.

Q. Take two hours?

A. No, I don't think I would be gone two hours at a time.

Q. How long would you be gone at a time, now, this is during the first period that you went to work for Mr. Rau?

A. Well, I wouldn't know what to say to you there, because I would go to the grocery store and I would get material to make clothes.

Q. What would you do at the grocery store, Mrs. Dorsey?

A. Well, I cooked his—I got to cooking his meals in the room. [597]

Q. You got to cooking his meals. Now, was that the understanding when you were hired that you would cook his meals in the room?

A. No, sir.

Q. When did that start?

A. Right after—well, right after he was up.

Q. Excuse me? A. Right after he got up.

Q. Right after he got up? A. Yes.

Q. Now, we are talking about the time that he

(Testimony of Betty Dorsey.)

was in bed; you said that you weren't there all the time and you would be out shopping.

Now, how long were you out shopping?

A. Well, as long as to get me to take—get some material to make him some clothes to wear.

Q. He didn't have any clothes when you were first hired?

A. He didn't have clothes, but they didn't fit him to suit me.

Q. How do you know whether they fit him to suit you, when he was in bed all the time? Did you dress him and put him in bed?

A. I made pajamas, sir.

Q. You mean pajamas? [598]

A. Yes, sir.

Q. You wanted to make him some pajamas; is that it? A. That is what I did, sir.

Q. I see. How long did you—do you estimate you were gone from his room on each day during the initial period that you were employed?

A. Not too long. I wouldn't tell you how long, because I don't know, but '45 is a long time back.

Q. Yes, it is. What I am trying to find out is how he could get this liquor up there and remain intoxicated when you were with him constantly.

Now, that is not possible, is it Miss Dorsey?

A. Yes, because he had a phone by his bed, and he could use his phone and have his liquor sent up.

Q. All right. And who would receive that liquor, would that be you?

A. No, because I wouldn't be in the room.

(Testimony of Betty Dorsey.)

Q. You wouldn't be there?

A. While I am out, he is getting his liquor.

Q. Now, were you out every day?

A. Yes. I went out every day.

Q. You went out every day? A. Yes, sir.

Q. How long would you be out? [599]

A. That I can't answer you.

Q. Now, is it possible that also the time you were out every day that Mr. Webb or Miss Goldstein came up and talked to him about the business?

A. Miss Goldstein never did come up. That is, Miss Goldstein did not come up in the room while I was there.

Q. Did Mr. Webb?

A. Yes, Mr. Webb did come up.

Q. Mr. Webb did come up? A. Yes.

Q. And he talked to him about the business?

A. I don't know what he talked about.

Q. Where were you?

A. I would go in the other room. That was not my concern.

Q. That was not your concern. But you do know that Mr. Webb did come up there, didn't he?

A. Yes.

Q. And could you state whether or not he was carrying anything at the times that he would come up?

A. Why, I never saw him have anything in his hands.

Q. You never saw him?

(Testimony of Betty Dorsey.)

A. I would see him come in the room, and then I would [600] step in the other room.

Q. You would see him but he could have had something in his hands; you didn't notice, did you, Mrs. Dorsey?

A. No. I would have noticed if he had something in his hand.

Q. You would have noticed? A. Yes.

Q. Is it your testimony that he never came up in his room while you were there with anything in his hands? A. Yes, sir.

Q. That is your testimony, isn't it? Now, you weren't there all the time, though, were you, Mrs. Dorsey? A. No, sir.

Q. And what he did during those times that you were not there, you cannot testify as to whether or not he came up and at that time discussed the books and records, can you? A. No.

Q. Now, you were gone each day of your employment from 1945 on, at some period of the day, weren't you, Mrs. Dorsey?

A. I would have to go out and get groceries.

Q. Of course. And you wouldn't want to stay in the hotel room or by his side all the time, would you?

A. Well, I was by his side practically all the time. [601] I even had to sleep where he could call me.

Q. Surely. Now, you say you taught him to walk again, and that was in 1945, wasn't it?

A. Yes, sir, when he got up out of bed.

(Testimony of Betty Dorsey.)

Q. You taught him how to walk again? Did he continue drinking?

A. Yes, sir.

Q. He continued drinking. And he was able to walk, though? A. Yes, sir.

Q. And he would go to the elevator and he would go downstairs, wouldn't he?

A. Yes, sir.

Q. And he would walk around downstairs, and you would be up?

A. I don't know what he did, walked around downstairs, or what he did out of my sight.

Q. You don't know, do you, but he would be gone for periods of time each day, wouldn't he?

A. Not very long at a time.

Q. Not very long at a time, but he would be gone?

A. He would be gone out of the room, but he wouldn't be gone long at a time.

Q. How long would he be gone, Mrs. Dorsey?

A. Oh, gosh. I never think of time. [602]

Q. I see. Time just doesn't—you don't nail things down by hours, or two hours, or——

A. No, sir. When you are working, taking care of sick, you cannot.

Q. I see. But in any event, every day Mr. Rau would go out to the elevator and go down and then he would walk around with this cane that he had, didn't he?

The Court: I instruct the witness to answer orally, rather than nodding her head.

(Testimony of Betty Dorsey.)

The Witness: I think I do nod my head when I talk.

The Court: The reporter cannot always see you nodding your head.

The Witness: Beg your pardon. I am trying to talk loud.

Mr. Gardner: I am sorry, your Honor.

Would you read the previous question, please?

(Question read.)

The Witness: Well, I knew he walked from the room to the elevator and outside of that I don't know anything about it, because I wasn't with him.

Q. (By Mr. Gardner): You weren't with him. In other words, he could have walked all over the place and you wouldn't have known it, would you?

A. As far as I am concerned. [603]

Q. Now, was he having trouble with his legs at this time?

A. Oh, yes. His legs were swollen so he couldn't sit down with him.

Q. They were swollen? A. Yes.

Q. He had difficulty in walking on them, in fact, didn't he? A. Yes, sir.

Q. If he became intoxicated, he couldn't walk on them at all, could he, Mrs. Dorsey?

A. Well, he would go up to his room and lay down.

Q. That is what he would do when he was fully intoxicated, wouldn't he? Now, I believe you have

(Testimony of Betty Dorsey.)

stated that when Mr. Webb came and discussed business, you left the room; is that right?

A. Well, I don't know if he came to discuss business or not. I don't know what he did.

Q. You don't know, but he was almost a daily visitor when Mr. Rau was confined to his room, wasn't he? A. Yes, sir.

Q. And that happened on all occasions when Mr. Rau was confined to his room, Mr. Webb would come up there and talk to him, wouldn't he?

A. He would come up there; yes, sir. [604]

Q. And you would leave, wouldn't you, because that was none of your business?

A. I wouldn't leave, but I went in the room, other room.

Q. You wouldn't, couldn't hear what they were talking about, could you? A. No, sir.

Q. Now, Mr. Simpson asked you whether or not Mr. Rau appeared to be sharp mentally, and you stated, I believe, not always. Would you clarify that answer, please?

A. Well, he would be kind of, I don't know just how to express it, but he wouldn't, he didn't seem to have any interest, or any—he would come to the room and lay down and that is it.

Q. Now, when he was sharp mentally, because as you stated not always, in some occasions when he was sharp mentally, wasn't he?

A. I would say not all the time that I was with him.

Q. But some of the time?

(Testimony of Betty Dorsey.)

A. No, he never was what I would call sharp.

Q. He never was what you would call sharp?

A. No, sir.

Q. Did you ever discuss any financial matters with Mr. Rau? [605] A. No, sir.

Q. You never did. What did you discuss with Mr. Rau?

A. Oh, I don't know. What he would like to eat, or if I could fix him something to eat, or——

Q. Did you ever hear him discuss business with anyone else? A. No, sir.

Q. You can't say whether or not he was mentally alert as to business, can you then?

A. Well, I don't think so.

Q. You cannot state that, can you? In fact, as far as you are concerned, and as far as you know, he could be very, very sharp mentally, couldn't he?

A. No, sir, he could not.

Q. Why was that now?

A. Because he didn't have the right, well I can't answer that either.

Q. You can't answer it, can you?

Now, he was making a substantial income during this period, wasn't he, Mrs. Dorsey?

A. As far as I know, I don't know anything about his income.

Mr. Simpson: The witness testified she doesn't know anything about his business transactions. That wasn't even covered on direct examination [606] either.

Mr. Gardner: That is what we are concerned

(Testimony of Betty Dorsey.)

with here, and I believe her testimony relates to mental capacity, mental capacity relating to business.

If we stipulate that she knows nothing of his mental capacity as to business matters, I am very happy.

Mr. Simpson: I am objecting to the question, not to be drawn into a stipulation of that nature, but because it goes beyond the scope of the direct. She has already said that she did not discuss business or his finances with him.

The Court: The witness answered that she didn't know. You may proceed.

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): Now, the only time actually that he was confined to his room in 1945 was the initial period that you were there? Is that correct, Mrs. Dorsey?

A. I was there with him all the time in '45, but the first three weeks he was confined to his bed.

Q. He was confined to his bed then, and after that, he was not confined to his bed; is that right?

A. Well, he was in bed most of the time.

Q. Well now, did he get up and did he walk around?

A. He would get up and walk around some, but not much. [607]

Q. Would he go downstairs?

A. I answered that, yes, sir.

Q. Yes, sir, he would. Now, did that continue throughout the year, the remainder of the year '45?

(Testimony of Betty Dorsey.)

A. Yes, sir.

Q. And did it continue throughout the year 1946?

A. In '46, I think that it was that he moved out to his home and I went out there with him.

Q. And when about was that in 1946?

A. I will not try to say, but I think it was in the spring of the year.

Q. Spring of the year of 1946?

A. Yes, sir.

Q. Now, when you went out to his home, did Mr. Rau make a practice of coming to the Southern Hotel daily?

A. Well, I wouldn't say daily, but I did take him up to the Southern Hotel. I would have to help him in and out of the car, to get him up there.

Q. And when he got out, did he walk with the aid of his cane? A. Yes, sir.

Q. And he was a big man, now, wasn't he?

A. He was 230 pounds.

Q. 230 pounds. Now, if he was thoroughly intoxicated, you couldn't possibly carry 230 pounds, could you, Mrs. Dorsey? [608]

A. I couldn't carry it, but I lifted it.

Q. You could lift it? A. At that time.

Q. I see. Did you ever have to lift him?

A. Yes, sir.

Q. When he was intoxicated in and out of the car? A. Because when he was sick——

Q. Just when he was sick?

A. When he was sick and from liquor.

(Testimony of Betty Dorsey.)

Q. But he would be lying in bed, is that the idea, Mrs. Dorsey?

A. Well, he never did stay up any length of time. He would get up and go to bed and then you would get him up and get him in bed, and then he would want to get up. And I used to take him under the armpits and lift him in his chair, and back in his bed.

Q. I see.

The Court: After he moved to his house in 1946, how often did he come down to the hotel?

The Witness: Well——

The Court: Was it nearly every day?

The Witness: Well, say nearly every day.

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): And why did you come down to the hotel, Mrs. Dorsey? [609]

A. Well, to get him out of the house, to give him a ride.

Q. Did he request it?

A. Well, he would want to go some place.

Q. He wanted to go to the hotel?

A. And he would want to go down and look at the hotel. It wouldn't be there long.

Q. But he did want to go down there and look it over? A. I don't know but he would go down.

Q. That is the reason you went to the hotel, because Mr. Rau wanted to go there?

A. Yes, sir.

The Court: Did you have a chauffeur?

(Testimony of Betty Dorsey.)

The Witness: No, sir. I drove from the time I went to work for him.

The Court: You drove?

The Witness: Yes, sir. I had to do all the driving?

Q. (By Mr. Gardner): Now, while he was out at the home, at his home in 1946, I believe you stated about the spring of the year: was that correct?

A. I think so. I am not positive, that is a long time.

Q. Well, it surely is, and you are doing very well. [610] But when he did move out to this home, did he spend most of his time at the home, or down at the Southern Hotel? A. At the home.

Q. At home? A. Yes, sir.

Q. And how much time a day would you estimate he spent at the hotel?

A. You would just about get him up there and you would have to take him back.

Q. Was he suffering from intoxication during this period, Mrs. Dorsey?

A. Well, he wasn't suffering from intoxication. What I mean, he was suffering for the simple reason that he had drank so much, then you had to give him so much liquor all the time.

Q. You had to give him so much liquor?

A. Yes, sir.

Q. Were you furnishing that to him?

A. I had to give him some each day to keep him, not make him drunk, but to keep him agoing

Q. In other words, he wasn't drunk then during

(Testimony of Betty Dorsey.)

this period then, was he? You were rationing his liquor, weren't you?

Mr. Simpson: What period is this now?

Mr. Gardner: This is in 1946 after he moved out to the [611] home and she moved with him.

The Witness: Well, he would be, sometimes he would get pretty intoxicated out home.

Q. (By Mr. Gardner): How would he get intoxicated, if you were rationing his liquor for him?

A. You just had to give him it to him; if he wanted a drink, I would give it to him.

Q. Were you making him intoxicated, Mrs. Dorsey?

A. No, sir, I was not, because I had to work too hard to clean up after him.

Q. But you were attempting to keep him from becoming intoxicated, weren't you?

A. Yes, sir.

Q. And I believe you testified that you gave him just enough to keep him going?

A. Some days one little drink would knock him for a loop. He was weak and that.

Q. During this period, at least you attempted to keep him from becoming intoxicated, didn't you?

A. Yes, sir.

Q. And you were successful to an extent, weren't you, Miss Dorsey? A. To an extent.

The Court: How much liquor did he drink; do you have [612] any recollection as to the amount that he drank over a period of one day?

A. I never kept, your Honor, I never would

(Testimony of Betty Dorsey.)

keep a track of it, but at least in 24 hours it would be a fifth that he would consume, easy, because I had to be up nights with him, and in fact, I slept right in the room where I could take care of him.

The Court: Were those exceptional days or was that the usual amount of liquor he drank?

The Witness: Well, it was days one way and days another way.

Q. (By Mr. Gardner): Now, going on over into 1947, Miss Dorsey, you were with him during that period of time, too, were you not, and did this same condition prevail, that is, he would get up in the morning? A. Yes, sir.

Q. And you would put him in the car and take him down to the Southern Hotel?

A. I would get him up in the morning and bathe him, and clean him and dress him. He never could dress himself. I dressed him from the time I went to work for him, and I would get his breakfast and then oh, around, maybe 11:00 o'clock, maybe he would go uptown.

Q. You would go uptown because Mr. Rau wanted to go [613] uptown, wouldn't he, and you would go to the Southern Hotel? A. Yes, sir.

Q. And this happened almost every day during 1947, didn't it, up until the time the hotel was demolished?

A. Well, I don't know every day or not; I don't remember.

Q. Was it almost a daily occurrence, do you remember?

(Testimony of Betty Dorsey.)

A. It was quite often. I am going to say it that way.

Q. All right. Did Mr. Webb ever come out to this residence of Mr. Rau's during the year 1947?

A. Yes, sir.

Q. Rather frequently?

A. No, sir. I would invite them out to eat.

Q. I see. Sort of a social situation?

A. Yes, sir.

Q. Did he ever call out there to discuss business with Mr. Rau that you know of?

A. Not that I know of.

Q. Not that you know of. In fact, all their business was discussed down at the hotel, as far as you know; is that correct?

A. If there was any business discussed, it was.

Q. It was discussed at the hotel. You didn't [614] stay with him while he was in the hotel, did you Miss Dorsey? A. No.

Q. That applies to——

A. Once in a while I would go in and stay until he was ready to go. He wouldn't be gone long and he would want to go home.

Q. The general practice when you took him down to the hotel, was let him out and wander around and do what he wanted to?

A. That is all I could do.

Q. And you weren't with him, in the hotel?

A. You mean wandering around with him?

Q. Yes. A. No, sir.

Q. And you don't know whether or not he was

(Testimony of Betty Dorsey.)

discussing business during this time, or not, do you?

A. No, sir.

Q. He could well have been discussing business, couldn't he, Miss Dorsey?

A. I don't know anything about that, sir.

Q. How much were you paid when you first, you were first employed in 1945, Miss Dorsey?

A. Well, it was funny. He paid me $25 a week.

Q. And who did you reach this agreement with, Mr. Rau? [615] A. Mr. Rau.

Q. You talked it over with Mr. Rau?

A. That is the only one to talk to.

Q. Now, did he seem to know what he was talking about when he started talking about $25?

A. No, because he raised my salary in several weeks.

Q. Raised it to how much? A. To $35.

Q. To $35? A. Yes, sir.

Q. Did he state that he was satisfied with your services? A. Very much so.

Q. Very much so, and that is the reason he raised it; is that correct, Miss Dorsey?

A. I think that was it.

Q. At least he seemed to know the value of a dollar as far as your services were concerned, didn't he? A. I think, I hope.

Q. Now, how did he pay you?

A. Well, at that—I don't—I was trying to recollect. I think he paid by check.

Q. You think he paid by check. Now, did he instruct Mr. Webb to pay you?

(Testimony of Betty Dorsey.)

A. I don't know. I get my check and that is all [616] I know.

Q. Who gave you the check? A. Mr. Rau.

Q. Mr. Rau gave it to you, personally?

A. Yes, sir.

Q. And did you get the same amount, that is $35 a week, throughout the remainder of your employment with him?

A. No. In the latter years, and I don't know when they raised my salary to $50 a week.

Q. Who do you mean by "they"?

A. I don't know who did it. It was raised.

Q. And Mr. Rau started giving you a check in the amount of $50; is that right?

A. Well, Mr. Rau didn't give it to me. Then it was given to me through the bookkeeper, bank, or something.

Q. This was near the time of his death?

A. Yes, sir.

Q. And up until that time you received $35 a week? A. Yes, sir.

Q. Now, didn't you have any vacations during this period? A. No, sir, I did not.

Q. Do you have any family that you would visit?

A. No, sir. I am a woman by myself. [617]

Q. I see. And in other words, your sole thought and care during all these years was Mr. Rau, wasn't it? A. Yes, sir.

Q. Did you become rather fond of Mr. Rau; I mean, as a patient?

(Testimony of Betty Dorsey.)

A. You can't take care of a baby and not care for it. It is the same way with old people.

Q. You did care very much for Mr. Rau, didn't you?

A. No. I can't say that I cared a lot for him. I felt sorry for him and I will say it that way. He was helpless. He couldn't do anything for himself.

Q. Now, did you become acquainted with his family?

A. Well, yes. You can't help but become familiar with the family.

Q. When did you first become familiar with, say for example, Mr. Rau's son, Rau, Jr.?

A. Well, up at the hotel there, he came to see his father.

Mr. Simpson: If your Honor please, this definitely goes beyond the scope of the direct examination of this witness. I don't know that it is material to the inquiry before the Court, in any way. I think it is irrelevant and also goes beyond the scope of the direct examination.

Mr. Gardner: I would like to see what the relationship is that exists here, your Honor. This is vital testimony [618] and I would like to see whether or not there is any possible prejudice one way or another. I think I am entitled to interrogate into that.

Mr. Simpson: I think that the witness testified only with respect to the care that she gave Mr. Rau, Sr. And not with respect to whether or not she dis-

(Testimony of Betty Dorsey.)

liked or liked, or loved or hated anybody in the family, or any of his friends.

There is no question of whether or not she took care of this man.

The Court: I will allow Counsel reasonable latitude.

Mr. Gardner: Thank you, your Honor.

Q. (By Mr. Gardner): Now, when did you first meet Mr. Rau, Jr.?

A. Oh, I met Mr. Rau, Jr., there in the hotel, but not to know, not to speak to him or anything. But to really know him, or see him, was when he came to see his father there in the hotel.

Q. In the hotel, and became acquainted with him, at that time, didn't you? A. And his wife.

Q. With him and his wife. Did you like him?

Mr. Simpson: If your Honor please, now this is something that I feel that I must object to, whether or not this witness liked anybody. I don't get the significance [619] of it. I certainly didn't ask her on direct examination whether she liked or disliked anybody, or any member of Mr. Rau's family, or in-laws. That could go on ad infinitum into cousins, nieces, and how this can be helpful to this inquiry, I don't understand.

The Court: Counsel is entitled to explore the question of whether the witness might be prejudiced, and as I said before, within reasonable limits I will permit him to do so.

You may continue.

Mr. Gardner: Thank you, your Honor.

(Testimony of Betty Dorsey.)

Q. (By Mr. Gardner): Would you answer the question, please? A. I don't remember.

Mr. Gardner: Would you read the question again, please?

(Question read.)

The Witness: Well, God put us on this earth to like everybody.

Q. (By Mr. Gardner): Do you consider Mr. and Mrs. Rau, Jr., friends of yours, right now?

A. Well, I don't know. As far as I know, they are.

Q. You saw them rather frequently during these years, too, didn't you, Mrs. Dorsey? [620]

A. Not too frequently.

Q. How often would they come to visit Mr. Rau, Sr., during the years 1945, '46, '47, '8, '9, and '50?

A. I will not try to answer that, sir, because I cannot.

Q. Was it once a year, twice a year?

A. It was more than that, but how many times I don't know.

Q. Was it rather frequently?

A. No. I don't think it was. If I remember right —now, I am answering to something I am not positive.

Q. Well, that is all right. It is hard to remember, I realize that.

Now, you state that you have no family of your own, didn't you, Mrs. Dorsey?

A. No, I am by myself, sir.

(Testimony of Betty Dorsey.)

Q. All by yourself? A. Been for years.

Q. And in effect, you just sort of adopted the Rau family, didn't you?

A. When you are taking care of sick—may I answer it this way—you can't help but form a feeling for your patient and their family.

Q. And for these years, 1945 on up to the time Mr. Rau died, they were your family, weren't they, Miss Dorsey? [621] A. Yes, sir, they were.

Q. In fact, were you remembered in Mr. Rau's will?

Mr. Simpson: Object, your Honor. That goes beyond the scope of the direct examination.

The Court: The witness may answer.

The Witness: Yes, I was, but I didn't know it until after his death.

Q. (By Mr. Gardner): But you were remembered along with the other members of the family, weren't you, Mrs. Dorsey? A. Yes, sir.

Mr. Gardner: No further questions, your Honor.

Mr. Simpson: I have no questions, your Honor.

The Court: You may step down.

The Witness: Thank you.

(Witness excused.)

Mr. Simpson: If your Honor please, the Petitioner rests. [622]

* * *

WALTER SLATER

called by and in behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you be seated and state your name and your address, please?

The Witness: My name is Walter Slater; my address is 830 Laguna Road, Pasadena, California.

The Clerk: Thank you.

Direct Examination

By Mr. Werdel:

Q. What is your present business, Mr. Slater?

A. I am presently an officer with Cook Company, Equipment Company.

Q. How long have you been so employed?

A. Since the spring of 1954.

Q. Directing your attention to the year 1946 and 1947, is it true that at that time you were a revenue agent for the Bureau of Internal Revenue?

A. That is correct.

Q. Where was your position of duty at that time? A. In Los Angeles.

Q. In your capacity as revenue agent, were you instructed to examine the federal income tax returns of Walter F. Rau, Sr., of Bakersfield, California, for the years 1942, 1943 and 1944? [630]

A. I made examinations of Mr. Rau's returns in Bakersfield, and I'm quite sure those are the years, yes.

(Testimony of Walter Slater.)

Q. Was this examination performed at Mr. Rau's place of business in Bakersfield?

A. Yes, they were.

Q. What was—was that at the Southern Hotel?

A. That's correct.

Q. Do you recall what month of what particular year you made the examination?

A. I have had an opportunity to review the reports that I prepared, and I'm quite sure from the review of those papers that the examination was made in the fall of 1946.

Q. Did these records include the business known as the French Cafe? A. That's correct.

Q. You have examined the exhibits that have been placed in evidence in this case, have you not, this morning?

A. I have examined the reports that are prepared at that time.

Q. Based upon that examination and your recollection, can you tell us whether the system of bookkeeping was a double entry system?

A. To the best of my recollection I think, and as these are all of the books and records which I examined at that time, I would say they were on a cash basis, single [631] entry system.

Q. A single entry system? And on a cash basis for the purpose of determining income and loss for return purposes, is that correct?

A. That is correct.

Q. Were there any control accounts that you saw at the time of your examination?

(Testimony of Walter Slater.)

A. It is rather hard for me to recall at the time, but in reviewing the report and the books this morning, I would say that there was no control accounts.

Q. Could you as an experienced revenue agent examine the checks, stubs, and determine loss and gain of any of Mr. Rau's business if any?

A. I don't believe I understand that question.

Q. Could you just examine the check stubs, or the checks in the records that were supplied to you and determine gain or loss in any of Mr. Rau's businesses? A. No, I don't think so.

Q. Could you do so by examining the books of accounts without control accounts?

A. In Mr. Rau's case?

Q. Yes. In any of his particular businesses on any particular date, did you look at them and determine loss or gain?

A. I suppose it could be done. I recall that [632] I had considerable difficulty in examining the books and reconciling the books to the returns, but——

Q. Do you recall how many days you spent in your examination?

A. No, but I would imagine it would be four or five days. That would be the total time that I spent on a case.

Q. Well, in your opinion, were Mr. Rau's books and records adequate for the purposes of determining income and expenses?

A. In my opinion, no. I had, as I say, I had considerable trouble in examining the books and records for the purpose of verifying the returns; and I am

(Testimony of Walter Slater.)

not sure that even upon the conclusion of my examination that I had made what would be, what could be said a fully satisfactory examination of the books and records to verify the return.

Q. When you made the income tax review for the years '42, '43 and '44 for Mr. Rau, did you consult Mr. Rau's bookkeeper during the course of your examination? A. Yes, I did.

Q. Do you recall what her name was?

A. It was a Miss Goldstein.

Q. How often did you have discussions with her regarding the books and records during your investigation?

A. To the best of my recollection I was at this place of business, I would say two or three days at a minimum and each day I would discuss aspects of the return or the [633] books.

Q. Were these discussions held there at the Southern Hotel? A. That is correct.

Q. Did you inform Miss Goldstein that you were a revenue agent for the Federal Government?

A. Yes, I did.

Q. Did you ask her for all the books and records?

A. That is correct.

Q. Did she tell you that she had supplied you with all of the books and records?

A. I don't recall her making any statements such as that, but I would normally in examination ask for all books and records to support the return.

Q. Did Miss Goldstein co-operate with you in

(Testimony of Walter Slater.)

assisting you in the examination of the books and records?

A. Miss Goldstein provided the records that I examined. I didn't feel she was particularly co-operative as a representative of Mr. Rau.

Q. Will you explain your answer?

A. There were many questions in the examination of the books for the purpose of verifying the return, the income and expenses, and when questions were asked of Miss Goldstein regarding the books and records for the returns, she was not very responsive, nor helpful. [634]

Q. I show you what is Petitioner's Exhibit 20 in this case and ask you to examine that?

A. Are all these substantially the same in form?

Q. Yes.

I asked you to review them before the hearing this morning. I now direct your attention to the fact that those purport to be daily cash sheets for the year 1943 of the French Cafe representing what the particular person in charge of the cash register for the particular shift would take off the top and certain expenditures that were noted and made for the various days that they designate.

I ask you if that was part of the records that were given to you by Miss Goldstein?

A. I do not recall examining these records, no.

Q. I direct your attention to the fact that on all of these sheets there are notations on the bottom and on the side with certain amounts taken off the top and ask you if you recall whether or not those figures

(Testimony of Walter Slater.)

were on any records that were supplied to you by Miss Goldstein?

A. Could you identify of what you are speaking of here?

Mr. Werdel: If the Court please, some of these were particularly identified at the hearings, and I don't recall which they were at the present [635] time.

Q. (By Mr. Werdel): Directing your attention to the first sheet on Exhibit 20, it shows the receipts purportedly and evidenced by the tape on the particular date of $384.70, and that the total of $129 was paid out in cash leaving the balance of $283.86, and that thereafter there is $10 deducted showing a balance of $273.86; and that there was apparently put back in $33.35, and there was banked a total of $307.21.

I ask you if you ever saw the figure of $10 being subtracted without evidencing any cost on any daily slip?

A. I have no recollection of seeing these records, nor do I have any recollection of any so-called deduction of $10.

Q. I call your attention to some of these on week end which show $100 or more taken off the top. I assume that you didn't see any such entries either?

A. Not to my recollection.

The Court: You have no recollection of having seen these sheets which comprise Exhibit 20?

The Witness: I have no recollection of seeing the sheets.

(Testimony of Walter Slater.)

Q. (By Mr. Werdel): I show you Petitioner's Exhibit 21 purporting to be the same type of sheet for the year 1944 in connection with the same business, and I ask you if your answer would be the same in connection with that exhibit? [636]

A. Yes.

Q. That you don't recall having seen it?

A. My answer would be the same.

Q. Now, I show you Petitioner's Exhibit 27 purporting to be a copy of the report made by you after the examination that you have been discussing for the years 1942, 1943, and 1944, and I ask you if that is a copy of your report if you recognize it?

A. Yes, I do.

Q. I direct your attention to the fact that it is dated in late 1947, and I ask you if you believe——

Mr. Werdel: Withdraw the question.

Q. (By Mr. Werdel): That particular report was not prepared by you, is that correct? I mean, the typing of it was not done by you.

A. No, I did not type it. The schedules which are attached computing the tax and the depreciation schedules were prepared by me.

Q. Now, you have testified that your examination took place in the latter part of 1946, and I direct your attention to the fact that that report is dated November, 1947.

A. I am not positive as to when I made the examination, but from reviewing the consent form which was signed [637] by Mr. Rau which as I recall was dated in 1946, I am satisfied in my mind that I

(Testimony of Walter Slater.)

completed the examination in the fall of 1946, and prepared the report in November or December.

That date on the report is the date that it is mailed from the revenue agent's office to the taxpayer. It is not the date that I complete my examination.

Q. Now, after you had made your study for the Southern Hotel for the years we have discussed, did you discuss the results with Mr. Rau?

A. Yes, I did.

Q. I mean, Mr. Rau, Senior.

A. The taxpayer, yes, I did.

Q. Who was present when you discussed the results?

A. I am quite sure that I had at least two discussions with Mr. Rau. I had a discussion at the commencement of the examination to advise him who I was, what years I was going to examine. I had a final discussion with Mr. Rau at the time I had completed my report at which time I advised him of the adjustments to income and the change in tax as a result of my examination.

Q. Did you have that discussion with him alone without others present?

A. No, I did not. Mr. Rau was in bed during the entire time of my examination.

Q. And was—— [638]

A. I believe he was in bed during the entire time. At least he was confined to the Southern Hotel, and I was very concerned about Mr. Rau's health, and I insisted on either a doctor or a nurse being present

(Testimony of Walter Slater.)

at the time I presented to him the final results of my examination.

Q. Do you know Miss Betty Dorsey, the nurse of Mr. Rau?

A. I don't recall the nurse's name.

Q. Was a nurse present? A. Yes.

Q. Was Rose Goldstein present?

A. That I cannot be sure of.

Q. That discussion was held in his room at the Southern Hotel, I take it? A. That's correct.

Q. Did you make any observation of his mental condition at that time, as a lay person; was he able to go over the records with you, was his physical and mental condition such that he could? A. Yes.

Q. Now, based upon your knowledge of the physical and mental condition of Mr. Rau, do you believe he was able to understand his business condition by examining his books and records?

A. Whether or not Mr. Rau would be able to understand [639] his business condition?

Q. Yes. Would he be able to do the things to determine gain or loss from the records of the bookkeeper Miss Goldstein?

A. Oh, I assume that he would be able to.

Q. You do not know, is that your answer?

A. No, I wouldn't know.

Q. Do you know who set up the books, Mr. Slater? A. No, I do not.

Q. Did you make any determinations so as to establish an opinion in your own mind as to whether

(Testimony of Walter Slater.)

or not Mr. Rau left the management of his business to his employees because of his physical condition?

Mr. Schessler: I object to that, your Honor, on the grounds that this is a conclusion of the witness, that he wouldn't have any opinion. He was there for the purpose of examining the books and records. He was not there for any other purpose. I feel that that would be an improper question.

The Court: If the witness knows, he may answer. I don't want any conjecture.

Mr. Werdel: That is the question I asked him, if he knows.

The Court: If he knows, he may answer. He may not base his answer on conjecture. [640]

The Witness: I would not know.

Q. (By Mr. Werdel): Now, directing your attention to Exhibit 27, it is now in front of you, I ask you if in the preparation of the material on which the report was made whether you found any evidence that would justify recommendation of fraud in connection with the years 1942, 1943 and 1944, when you made your examination?

A. No.

Mr. Werdel: That is all.

(Testimony of Walter Slater.)

Cross-Examination

By Mr. Schessler:

Q. Mr. Slater, when you went to Bakersfield to examine this case, this taxpayer, did you have any other returns or were you just up there on this one examination?

A. No. I was assigned to Bakersfield from the Los Angeles office with several returns to examine.

Q. Several. Do you mean three or four?

A. No. It would be considerably more than that. I would say it would be most likely 25 or 30.

Q. How long were you in Bakersfield, Mr. Slater?

A. To the best of my recollection it was 60 days. It was a 60 day assignment from Los Angeles.

Q. Were you able to complete all of these returns while you were in Bakersfield? [641]

A. Not all of them.

Q. Were you pressed for time? A. Yes.

Q. Could we take it from that, that you were in a hurry to get through your examination or didn't perhaps go into them as thoroughly as you might have if you didn't have so many?

A. I think that is true.

Q. Now, I believe you stated that you had four or five days on this examination?

A. To the best of my recollection, that is correct.

Q. Did that include field time and report writing or just what was that?

(Testimony of Walter Slater.)

A. I do not think that I would have spent that amount of time examining the books and records of the taxpayer. It would be most likely two, two, to three days, total time.

Q. How many examinations of this taxpayer did you make? A. How many examinations?

Q. Yes. Did you make another examination, or is this examination that we are talking about that you have in front of you the only one?

A. That is the only examination that I made to my recollection.

Q. Now, where was Miss Goldstein when you were in [642] the hotel examining the books and records in relation to your position?

A. As I recall Miss Goldstein had a desk or office in the lobby, and there was a sign either on her desk or maybe it was on the outside of the hotel identifying Miss Goldstein as a Notary Public, and a person who prepared income tax returns.

She was in the lobby of the hotel to the best of my recollection.

Q. Where were you?

A. I worked in her office part of the time and in, I believe, they also had an accounting office or some facilities where they kept their books and records.

Q. You weren't at Miss Goldstein's desk when you were doing all this examining?

A. Not during the entire period of the examination.

Q. You stated that you saw Mr. Rau during that examination approximately two times?

(Testimony of Walter Slater.)

A. To the best of my recollection it would be twice, yes. It might have been more. I am not sure.

Q. Is it possible that you could have seen him more than twice? A. Yes.

Q. Where was Mr. Rau at the times that you can recall seeing him? [643]

A. He was confined to his room in the hotel.

Q. Was he able to move around in his room?

A. Possibly he was up once during the, or he was up out of bed during one of my visits there. I was concerned about Mr. Rau's health and the results of this examination on his health, and I think he might have been up out of bed once, but the other time I think he was confined to his bed.

Q. Do you recall talking to Mr. Rau?

A. Oh, yes.

Q. Did he understand what you were doing?

A. Yes.

Q. Did he know why you were there?

A. Yes, I'm sure he did.

Q. Would you explain what you mean how you are sure? You say you are sure he did understand, did you have a conversation with him or——

A. Most taxpayers recognize revenue agents, particularly when they identify themselves and they are concerned with the results of their review of the return and books and records, and Mr. Rau——

Q. And Mr. Rau?

A. And Mr. Rau was concerned as most other taxpayers.

Q. Now, I believe you testified as to Mr. Rau's

(Testimony of Walter Slater.)

physical condition. Did you at any time during [644] your examination notice Mr. Rau drinking?

A. No.

Q. And he was under the influence of an alcoholic during your discussions with him?

A. Certainly not. In my opinion he was not.

Q. Did you discuss your findings with anyone besides Mr. Rau?

A. I am not sure whether an attorney or accountant was called in by Mr. Rau at the conclusion of the examination or not. I do not recall.

Q. Do you recall whether Miss Goldstein was present at the time you discussed your conclusions with Mr. Rau?

A. That I could not be sure of.

Q. How long were you in Mr. Rau's room when you were talking with him; do you have any recollection?

A. Well, the first meeting with Mr. Rau when I advised him as to the purpose of my examining his books and records would have been a very short meeting; but the meeting with Mr. Rau at the time I advised him as to the results of my examination, I don't recall precisely, but I would imagine it would be an hour or two hours.

Q. In your examination of the tax returns for these years, what books and records exactly did you check, Mr. Slater?

A. To the best of my recollection it would have been [645] the cash journals, receipts and disburse-

(Testimony of Walter Slater.)

ments. I had considerable difficulty, as I had mentioned before, reconciling the books with the returns.

Q. In reference to the exhibits that you checked a minute ago, I believe they are exhibits 20 and 21, you stated that you didn't recall whether you examined those; is that correct?

A. I do not recall seeing any such records in connection with my examination, no.

Certainly they were not in looseleaf form like that. I don't recall reviewing such records at that time. I do remember there being a form of cash journal in bound form.

Q. That is all you can remember, some form of cash journal?

A. That is all I can remember, and I don't recall too much about that.

Q. That is hazy recollection?

A. That is correct.

Mr. Schessler: That is all. Thank you, Mr. Slater.

Mr. Werdel: If the Court please, I would just like to ask one more question.

Redirect Examination

By Mr. Werdel:

Q. Mr. Slater, was Rose Goldstein ever in the room [646] when you discussed any preliminary discussions rather that you had with Mr. Rau?

A. Rose?

Q. Was Rose Goldstein present when you had

(Testimony of Walter Slater.)

ever had a conversation with Mr. Rau in the course of this examination?

A. I can't be sure, but I assume she was at some time.

Q. Did you discuss the results of this examination with Rose Goldstein?

A. I can't say for sure whether I did or not.

Q. Mr. Slater, I take it it is true that some time in 1947, or at the close of your study and report, Mr. Rau did bring in a different bookkeeper, is that correct?

A. That I cannot be sure of. It was some time ago.

Q. Well——

A. I testified I think I completed this examination at the close of 1946.

Q. Yes?

A. I think the date of this report is not correct. I think it should be dated December, 1946.

Mr. Werdel: Well, perhaps I can state this to the Court. During one of the days that I was absent when the hearing was on, I understand that when Mr. Reed because of the death of a member of his family in the east or a serious [647] illness, was excused and at the time it was raised with regard to a stipulation that Mr. Reed prepared the 1947 return that is in evidence, and that some discussion was had upon the subject of where he derived his information for the 1947 return.

I have told Mr. Gardner that while I know personally that Mr. Reed made the 1947 return, I

(Testimony of Walter Slater.)

wasn't here for the conversations, and I would be perfectly willing at this time to agree that he can prepare a stipulation that it was—it was intended at that time for Mr. Simpson's signature with regard to this subject.

Mr. Schessler: Your Honor, may I say something on this matter?

The Court: Does this have anything to do with this witness' testimony?

Mr. Schessler: No.

Mr. Werdel: I am through.

The Court: Are both parties completed in their examination of this witness?

Mr. Schessler: We have no further questions at this point, your Honor.

Mr. Werdel: No further questions.

The Court: You may step down, Mr. Slater.

(Witness excused.) [648]

* * *

Received and Filed July 25, 1958.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the docu-

ments submitted under this certificate, 1 to 41, inclusive, as called for by the Designation of Contents of Record on Review, are the original documents on file in my office, excepting the original exhibits which are separately certified, and a true copy of the docket entries as they appear in the official docket of my office, in the case docketed at the above number, in which the petitioner in this Court has filed a petition for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 15th day of March, 1960.

[Seal] /s/ HOWARD P. LOCKE,
Clerk of the Court.

[Endorsed]: No. 16823. United States Court of Appeals for the Ninth Circuit. Estate of Walter F. Rau, Sr., Deceased, Raymond J. Shorb, Administrator With the Will Annexed, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed and Docketed: March 21, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16823

ESTATE OF WALTER F. RAU, SR., Deceased, RAYMOND J. SHORB, Administrator With the Will Annexed,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

STATEMENT OF POINTS RELIED UPON

Pursuant to Rule 17 Sub-paragraph 5 of the Rules of the Court, the Petitioner sets forth the points upon which it intends to rely:

(1) The penalty provided for under Section 293(b) I.R.C. 1939, does not survive the death of a decedent when death occurred prior to the imposition thereof.

(2) The net worth method represents the only reasonable basis upon which decedent's income can be properly determined.

(3) The evidence presented by Respondent fails to support its allegation of fraud within the meaning of Section 293(b) I.R.C. 1949.

(4) Under the rules of evidence, Respondent's witnesses have been impeached and discredited.

(5) The Statute of Limitations is a bar to the assessment and collection of any tax for the years 1942, 1943 and 1944.

/s/ ELLSWORTH T. SIMPSON,
Attorney for Petitioner on
Review.

Certificate of service attached.

[Endorsed]: Filed March 24, 1960.

NO. 16834

United States
COURT OF APPEALS
for the Ninth Circuit

RUSHLIGHT AUTOMATIC SPRINKLER CO.,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

UNITED STATES OF AMERICA,
Appellant,

vs.

RUSHLIGHT AUTOMATIC SPRINKLER CO.,
Appellee.

APPELLANT'S and CROSS-APPELLEE'S REPLY BRIEF

Appeals from the United States District Court for the District of Oregon.

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NO. 16834

United States
COURT OF APPEALS
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RUSHLIGHT AUTOMATIC SPRINKLER CO.,
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vs.

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UNITED STATES OF AMERICA,
Appellant,

vs.

RUSHLIGHT AUTOMATIC SPRINKLER CO.,
Appellee.

APPELLANT'S and CROSS-APPELLEE'S REPLY BRIEF

Appeals from the United States District Court for the District of Oregon.

THE ERRONEOUSLY ALLOWED TAX CREDIT WAS NOT A REFUND WITHIN THE MEANING OF SECTION 3746

On page 9 of its brief the government concedes that "if this were an action to collect a statutory deficiency in tax it would be necessary to first issue a deficiency

notice, and we concede that such notice has not been issued here."

To clarify the issues we will make a like concession: If the erroneous credit in question constituted a refund of taxes to appellant within the meaning of Section 3746 of the Internal Revenue Code of 1939, then the government is entitled to prevail.

Most of the government's argument is based on its premise that the erroneous tax credit was such a refund. If this premise is not correct then its argument completely fails.

The crucial point is that at which the government seeks to attach the label "refund to the appellant" to the erroneous credit in question.

On page 8 of its brief the government starts out mildly by saying that the tax credit "is in the nature of a tax refund." It initially cites for this proposition *United States v. Failla,* 3 Cir., 219 F2d 212, a renegotiation collection suit. However, an analysis of that case shows that the court there recognized that the tax credit was a tentative matter and any errors therein were to be corrected under the refund and deficiency procedure under the Internal Revenue Code. In that case the contractors were claiming that they had not been allowed a sufficient tax credit and the court held that the amount of the tax credit had to be determined under the administration procedures set forth in the Internal Revenue Code, i.e., a refund claim must be filed. This conclusion was based upon Judge Hand's opinion in *Stow Mfg. Co. v. Commissioner*, 2 Cir., 190 F2d 723, which

case was one involving the converse situation, i.e., too much tax credit was given which was held to have created a deficiency in tax. (See appellant's opening brief, page 5.)

Certainly this case does not support the proposition that the erroneous tax credit given the Rushlight-Macri joint venture was a refund to appellant. Nor do the other cases cited by the government on page 9 of its brief. In *Universal Oil Products Co. v. Campbell,* 181 F2d 451, the court used the government's magic word "refund" but such use was coupled with the statement that such credit *"must be considered in determining the amount of any deficiency"* in the taxpayer's taxes. The other two district cases cited by the government merely repeat what the court said in the *Universal Oil* case.

As to the four cases cited on page 11 of the government's brief, although the government says that they are cases where there was "money erroneously credited to the taxpayer," in each case the amount in question was *refunded to the taxpayer by government check.*

Nor does the case (*Merlin v. Sanders,* 243 F2d 821) which the government says dramatically points up its position change the situation. In fact that case, if carefully read and understood, dramatically points up our position. The facts in the *Merlin* case are complicated, but there were two different proceedings involved, the significance of which has completely escaped the government:

(1) Proceedings No. 1 was the suit to enjoin an attempted assessment on the part of the Director

without giving a deficiency notice. The taxpayer had taken an erroneous credit on her 1949 return in the sum of $487.08, an amount which had been refunded to her after she had filed her 1948 return.

(2) Proceeding No. 2, the one mentioned by the government in its brief, was one brought by the United States to intervene in the injunction suit and collect the amount of $487.08 which was included in a second refund check sent to the taxpayer on April 18, 1950.

As to Proceeding No. 1, the lower court entered a preliminary injunction and then later "granted the taxpayer's injunction on the ground that no statutory notice of deficiency had been sent by the Director but held that the United States was entitled to recover the amount erroneously refunded to taxpayer on April 18, 1950, plus interest."

There was no appeal from the judgment granting the injunction, and therefore the lower court's holding stands as authority for the proposition that even though there was an erroneous credit the provisions as to giving the statutory notice are still mandatory.

Furthermore, a correct understanding of the case destroys the logic of the government's attempt to distinguish *Maxwell v. Campbell*, 205 F2d 461 (ff 1, p 13).

In *Maxwell v. Campbell* the proceeding in question arose because "erroneous credits were revised." This was held to create a deficiency which required the statutory notice.

Furthermore, there is no difference between an action and an assessment, as the government suggests. *United States v. Price,* 9 Cir., 263 F2d 382, was a case where an action was brought. Although the case was reversed on another ground (361 US 304) the fact that an action cannot be brought to collect a deficiency was not questioned.

The government does not even attempt to distinguish the erroneous credit case from this circuit, *Jameson v. Repetti,* 239 F2d 901.

The government's argument on page 15 of its brief as to the statute running has no validity here since it is based on the government's statement that the statutory period for assessment ran three years after the return for the fiscal year ending October 31, 1953 was filed on April 14, 1954. This completely overlooks the exception to Section 275 (a) i.e., Section 276, the pertinent provisions of which are:

> "(d) * * * In the case of a deficiency attributable to the application * * * of a net operating loss carry-back * * * such deficiency may be assessed—
>
> "(1) In case a return was required * * * for the taxable year of the net operating loss * * * resulting in the carry-back, at any time before the expiration of the period within which (under Section 275 * * *) a deficiency * * * for such taxable year * * * may be assessed."

The record does not show when Rushlight's fiscal 1955 return was filed, but under this exception the time for assessment did not even start until the filing of that return.

Although the government seeks to disregard the joint venture, the fact remains that (a) the renegotiation agreement was between the government and the joint venture (Ex. 8); (b) it was the joint venture's profits that were eliminated by agreement (Ex. 8); (c) the demand for payment was made to the joint venture and the credit granted the joint venture was the combined tax credit for all the venturers (Ex. 5); (d) the payment of the net amount due was made by the joint venture's check (Ex. 1(c)).

We submit that the problems which arise because a joint venture or partnership is treated as the contractor under the Renegotiation Act shows the wisdom of the statutory scheme of treating the correction of errors in tax credits under the Internal Revenue Code's procedures for the collection of deficiencies. (See discussion in *Morris Kurtzon,* 17 TC 1542, factually on all fours with the case at bar.)

Respectfully submitted,

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No. 16858

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAYBEE MANUFACTURING CORPORATION,

Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,

Appellee.

APPELLANT'S BRIEF.

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JAYBEE MANUFACTURING CORPORATION,

Appellant,

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Appellee.

APPELLANT'S BRIEF.

STATEMENT OF JURISDICTION.

This action was instituted by plaintiff Ajax Hardware Manufacturing Corporation for infringement of a design patent, No. Des. 182,602. The complaint appears at page 3 of the record. The jurisdiction of the District Court was invoked under Title 35, Patents, of the United States Code and is further supported by §1338 of Title 28 of the United States Code. The answer of defendant Jaybee Manufacturing Corporation is set forth at page 7 of the record. The answer places in issue the questions of validity and infringement. The answer contains a counterclaim for declaratory relief [R. 9] seeking a declaration that the plaintiff's patent No. Des. 182,602 is invalid and not infringed. The jurisdiction of the Dis-

trict Court was invoked under §2201 and §2202 of Title 28 of the United States Code and is further supported by §1338 of Title 28 of the United States Code.

Plaintiff's answer to the counterclaim [R. 14] denied the allegations of invalidity and non-infringement but admitted the issuance of threatening letters such as Exhibits N-1 and N-2 [R. 51-52].

The action was tried on the issues framed by the Complaint for Infringement of United States Letters Patent No. Des. 182,602 [R. 3], Answer containing Counterclaim for Declaratory Judgment [R. 9] and Answer to Counterclaim [R. 14]. The District Court made its own findings of fact, conclusions of law and judgment [R. 30]. The judgment dismissing both the complaint and the counterclaim [R. 32] was entered on February 16, 1960, as evidenced by the notice of entry of judgment [R. 33]. A notice of appeal was timely filed on March 17, 1960 [R. 34].

This Court has jurisdiction of this appeal pursuant to §1291 and §1292(4) of Title 28 of the United States Code.

STATEMENT OF THE CASE.

The findings of fact, conclusions of law and judgment [R. 30-32] of the District Court hold the design patent in suit valid but not infringed. This appeal has two facets.

The first has to do with the District Court's dismissal of defendant's counterclaim for declaratory judgment. Inasmuch as the District Court found the patent not to be infringed, defendant-appellant through this appeal as-

serts its right to an injunction in order to prevent any additional threats of infringement suits by plaintiff against defendant's customers. By prosecuting the appeal on this point, the defendant hopes to preclude any multiplicity of litigation involving the particular devices accused of infringement. The issue is raised by the appeal from "that portion of the Judgment [which provides:] That defendant take nothing by reason of its counterclaim." and as set forth in the Notice of Appeal to Court of Appeals [R. 34].

The second facet of this case challenges the District Court's holding of validity and as embodied in the findings of fact and conclusions of law, and particularly Finding of Fact No. 2 [R. 30] and Conclusions of Law No. 2 [R. 32]. The issue is raised by the appeal "from that portion of the Findings of Fact, Conclusions of Law and Judgment . . . which find, conclude or adjudge that . . . Patent No. Des. 182,602 is valid.", and as set forth in the notice of appeal [R. 34]. This issue is also raised by the appeal from that portion of the judgment above quoted which dismisses the defendant's counterclaim, in that the counterclaim sought a declaration of invalidity of the patent in suit.

Although the devices accused of infringement were held not to infringe the patent, defendant-appellant is seriously concerned with the question of validity. Both parties are manufacturers of builders' hardware. Defendant-appellant naturally hopes to continue in business and add new items to its line. Plaintiff-appellee may believe

or be advised that such new items infringe the patent in suit. Unless this patent is now held invalid, defendant clearly runs the risk of further litigation based upon this patent which defendant believes should be held invalid. Defendant can ill-afford not to prosecute this appeal because the issue once finally decided will be binding. There is, of course, also a serious public interest involved when the validity of a patent is in question.

The question of validity will be decided upon a record of physical exhibits. The District Court in its memorandum decision [R. 17] conceded:

> "The question of the validity of the design patent presents a much closer question from two standpoints—whether the design was anticipated by prior art and whether Leichter was the sole inventor, . . ."

The latter question is not involved in this appeal. Defendant-appellant will show that the District Court reached the wrong conclusion as to the issue of anticipation or lack of invention.

SPECIFICATION OF ERRORS.

1. The District Court erred in finding that United States Letters Patent No. Des. 182,602 was duly issued to plaintiff, as set forth in Finding of Fact No. 2 [R. 30].

2. Except for the exceptions therein noted, the District Court erred in finding that the allegations of defendant's Counterclaim are not true and as set forth in Finding of Fact No. 8 [R. 31].

3. The District Court erred in concluding that United States Letters Patent No. Des. 182,602 is valid and as set forth in its Conclusion of Law No. 2 [R. 32].

4. The District Court erred in concluding that defendant is entitled to no relief under the allegations of its Counterclaim and as set forth in its Conclusion of Law No. 4 [R. 32].

5. The District Court erred in holding that the defendant take nothing by reason of its counterclaim and as set forth in Paragraph 2 of its Judgment [R. 32].

SUMMARY OF ARGUMENT.

1. The suit for declaratory relief was properly brought.

2. Defendant Jaybee Manufacturing Corporation was entitled to relief under §2202 of Title 28 of the United States Code.

3. The question of validity is properly before this Court of Appeals.

4. The limited and incomplete record before the Patent Office Examiner resulted in improper allowance of the patent in suit.

5. The Examiner failed to find the most pertinent references.

6. Presumption of validity is non-existent.

7. Tests of invention are strict.

8. Commercial success does not weigh in favor of the patent.

9. Application of the rules negates patentability and compels a holding of invalidity.

ARGUMENT.

1. The Suit for Declaratory Relief Was Properly Brought.

Defendant's Counterclaim alleges in Paragraph III [R. 10] that:

> "This is a counterclaim for declaratory relief; and the jurisdiction of this court depends upon Section 2201 and 2202 of Chapter 151 of Title 28 of the United States Code; an actual controversy between defendant, Jaybee Manufacturing Corporation, and plaintiff Ajax Hardware Manufacturing Corporation, exists as to alleged infringement by defendant of United States Design Patent No. 182,602 issued on April 22, 1958. . . ."

Plaintiff's answer to counterclaim states in Paragraph 3 [R. 15]:

> "Plaintiff admits the allegations contained in Paragraph III of said counterclaim."

Paragraph IV [R. 10] of defendant's Counterclaim states that:

> "Plaintiff has issued notices to the trade and to customers of defendant that the said plaintiff intends to prosecute the customers of defendant under said Design Patent No. 182,602 because of resale by said customers of goods manufactured and sold by defendant . . ."

That this is true, attention is invited to plaintiff's answer to counterclaim 4 [R. 15] which states that:

> ". . . plaintiff admits that it has issued notices to two customers of defendant as alleged in said Paragraph IV; . . ."

It is well established that an action for declaratory judgment is properly brought by an alleged patent infringer once he or his customers is threatened with an infringement suit, and in order to determine whether the patent is infringed or not.

Grip Nut Co. v. Sharp (7th Cir., 1941), 124 F. 2d 814;

Treemond Co. v. Schering Corporation (3rd Cir., 1941), 122 F. 2d 702;

Technical Tape Corp. v. Minnesota Mining & Mfg. Co. (2nd Cir. 1952), 200 F. 2d 876;

Massa v. Jiffy Products Co. (9th Cir., 1957), 240 F. 2d 702.

In the *Jiffy Products Co.* case, this court, through Judge Orr stated, at page 705:

> "Where the patent owner informs a customer of the alleged infringer that there is a violation of the owner's patent by the alleged infringer's manufacturing a certain item, there is sufficient controversy to allow the manufacturer to file suit . . .
>
> " 'The fact that a patentee's claim of infringement is a condition precedent of this type of action places the matter of adjudication of the patent within control of the patentee, for, if he wishes to avoid adjudication, he can refrain from making charges of infringement. But having made the charge, he then exposes himself to adjudication.' Borchard, Declaratory Judgments, (1941), 807."

2. Defendant Jaybee Manufacturing Corporation Was Entitled to Relief Under Section 2202 of Title 28 of the United States Code.

The defendant prayed [R. 13] that the court grant a final injunction enjoining and restraining plaintiff . . . from asserting, contending, claiming or alleging that the Design Patent No. 182,602 is or ever was infringed by defendant Jaybee Manufacturing Corporation or its customers, on account of the manufacture and sale by defendant or by the resale by its customers of the accused articles. The failure of the court to grant the injunction sought was clearly an error. The question is raised by Point on Appeal No. 5 [R. 35].

Section 2202 of Title 28 of the United States Code provides:

> "Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment."

Since the District Court properly found [R. 31] that the patent in suit was not infringed, it should have granted the injunction sought. Dismissing the counterclaim [R. 32] was error.

Attention is invited to the leading Supreme Court case of *Kessler v. Eldred,* 206 U. S. 285, 51 L. Ed. 1065. The plaintiff in that case brought suit to enjoin the owner of a patent from threatening suits, continuing suits or bringing suits against plaintiff's customers, and in view of the fact that the plaintiff had won an

adjudication to the effect that its cigar lighters did not infringe the patent owned by the defendant. Mr. Justice Moody stated:

> "An action at law would be entirely inadequate to protect fully Kessler's *unquestioned right,* and, under these circumstances, though there may be no exact precedent, we think that the jurisdiction in equity exists." (Emphasis added.)

The subsequent passage of the declaratory judgment statute, and particularly §2202 solves the problem that concerned the court so far as equity jurisdiction was concerned. But attention is directed to the fact that the court pointed to an "*unquestioned right*" to an injunction where the patent was held not infringed.

Presumably the plaintiff here will argue that having lost its suit for infringement, it will naturally refrain from harassing any of the customers of the defendant Jaybee Manufacturing Corporation. Defendant simply desires, by virtue of this suit, an injunction to fortify such protestations. Furthermore, in this connection, attention is directed to *Vermont Structural Slate Co. v. Tatko Brothers Slate Co.* (2nd Cir., 1958), 253 F. 2d 29, wherein the court stated:

> ". . . it is of little significance that defendant keeps insisting that it has no intention to harass plaintiff and its customers. Under the doctrine of Kessler v. Eldred, 206 U. S. 285, 27 S. Ct. 611, 51 L. Ed. 1065, plaintiff was entitled as of course to an injunction restraining Tatko, the unsuccessful patentee, and all persons claiming under the patent, from

bringing any action or otherwise threatening plaintiff on the basis of claims that there is interference with said patent by the use of pallets for the sale of slate to plaintiff's customers or purchasers, or by the use of said pallets in conjunction with plaintiff's business by any customer, user, purchaser or supplier of plaintiff, or in any way directly or indirectly using said patent to interfere with the business of plaintiff. If anything, the injunction as issued was too narrow in its scope, as it was not made applicable to the continued prosecution by defendant of an action already pending against one of plaintiff's customers in the United States District Court for Maine. There was ample residual power in the court to issue this permanent injunction, even though the original decree contained no such provision. 28 U. S. C. §2202; 6 Moore, Federal Practice (1953 ed., 1956 Supp.) §57.10."

Therefore, the District Court should have granted the injunction to which defendant is obviously entitled, and thereby avoid all possibilities of piecemeal litigation, however remote.

3. The Question of Validity Is Properly Before This Court of Appeals.

The District Court found in Finding of Fact No. 2 [R. 30]:

> "On April 22, 1958, United States Letters Patent Des. No. 182,602 was duly issued. . . ."

The District Court concluded in its Conclusion of Law No. 2 [R. 32]:

> "United States Letters Patent Des. No. 182,602 is valid."

Appellant's Points on Appeal No. 1 [R. 35] is that the District Court erred in finding in its Finding of Fact No. 2 that United States Letters Patent No. Des. 182,602 was duly issued. Point on Appeal No. 3 [R. 35] asserts that the District Court erred in concluding that United States Letters Patent No. Des. 182,602 is valid and as set forth in its Conclusion of Law No. 2.

Once it is decided what is and what is not prior art, the question of invention over that prior art is one of *law.*

In *Fritz W. Glitsch & Sons, Inc. v. Wyatt Metal & Boiler Works* (5th Cir., 1955), 224 F. 2d 331, the court stated at page 335:

> "And while infringement is usually a question of fact, on which the normal presumption of verity might attach to the findings of the Trial Court under Rule 52(a), F.R.C.P., the issue of whether a particular patent meets the requisite standard of invention essential to validity is now generally regarded as a fully reviewable question of law, . . ."

This circuit is fully in accord at least where the evidence is before the appellate court in precisely the same form as it was in the lower court.

Kwikset Locks, Inc. v. Hillgren (9th Cir., 1954), 210 F. 2d 483;

Oriental Foods, Inc. v. Chun King Sales, Inc. (9th Cir., 1957), 244 F. 2d 909.

4. **The Limited and Incomplete Record Before the Patent Office Examiner Resulted in Improper Allowance of the Patent in Suit.**

A copy of the Leichter patent in suit appears at page 46 of the record. It was admitted as Exhibit 1 [R. 38]. As shown in Fig. 2 of the patent, the handle is generally of very simple shape. It has the following features:

1. It is a bar type pull.
2. It is generally rectangular as shown in Fig. 2, with sides bowing outwardly.
3. The handle is concave in transverse section.
4. It has a lens shaped cut-out in the central bar portion.
5. The pull has a downward arch as illustrated in Fig. 3.

There were two references and only two references that the Patent Office Examiner cited against the Leichter patent: Heyer, D 169,257 [R. 48] and Clayton D 180,684 [R. 49]. These patents were admitted as Exhibits 5 and 6 [R. 38]. See the certified file history of the Leichter patent, physical Exhibit M admitted in evidence [R. 43]. Samples of these pulls, the only two that the Patent Office Examiner deemed pertinent, or was able to find were admitted in evidence as physical Exhibits M-1 and M-2 [R. 44-45] to which reference is here made. These prior art pulls known to the Examiner had very little in common with the Leichter design, and in view of the limited and incomplete record there before him, the Examiner felt justified in allowing the Leichter patent.

Thus, as to the *Heyer* patent, Exhibit 5 [R. 48] and Exhibit M-1:

1. It is, true enough, made of bar metal.
2. It is clearly not of rectangular configuration. It is a half-circle.
3. The Heyer pull is, true enough, concave in transverse section.
4. There is no sort of opening at all in the Heyer pull, much less one corresponding to a lens shape.
5. There is no suggestion of longitudinal curvature whatsoever in the Heyer pull.

The similarities are clearly outweighed by the dissimilarities. There is hardly anything in common so far as overall appearance is concerned.

With respect to the Clayton patent, Exhibit 6 [R. 49] and Exhibit M-2:

1. It is not made of bar metal. It is made of a loop of rod-like material.
2. It is generally rectangular only in the very loose sense that it is longer than it is wide.
3. There is not the slightest possibility of the Clayton pull suggesting transverse curvature.
4. There is in Clayton a thin very long opening in the center, but this is formed not as a cut-out in bar metal. Instead it is formed as an incident to the fact that the face of the pull is simply a squashed or oblate loop of rod. The ends of the opening go beyond the mounting posts, unartfully revealing them.
5. Finally, there is a longitudinal arch in Clayton, but the longitudinal arch is up, not down!

In almost every point, the Clayton pull is unlike the Leichter pull. It falls far short of being pertinent.

5. The Examiner Failed to Find the Most Pertinent References.

Defendant filed Request for Supplemental Admissions [R. 64] which were admitted in evidence [R. 41]. These requests for supplemental admissions asked plaintiff to concede that certain Exhibits A, B, C, F, G, H, I, K and F-1 among others, were prior art. For example, Request for Admission No. 32 states:

> "Defendant's Exhibit A, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter."

If this statement is true, §102 of Title 35 of United States Code establishes such Exhibit A as prior art. Similar considerations apply to the remaining exhibits of this group. The Plaintiff's Response to Second Supplemental Request for Admissions is printed in full between pages 67 and 79 of the record, and was received in evidence [R. 41]. It will be clearly noted that the plaintiff made *no answer* to Requests for Admissions Nos. 32, 33, 34, 37, 38, 39, 64 and 65. With respect to Request No. 66, defendant conceded that if a small catalog not 8½ x 11 was meant (which it was) the request was admitted. Exhibits A, B, C, F, G, H, I, K and F-1 were thus conceded to be prior art devices *that were unknown to the Patent Office Examiner.*

Exhibits A, B, C, F, G and H were received in evidence [R 41]. Exhibit I was received in evidence [R. 41]. Exhibit K was received in evidence [R. 42]. Exhibit F-1 was admitted in evidence [R. 42].

Exhibits D and E-3 were admitted in open court to be prior art. In this connection attention is invited to the record at page 44, wherein counsel for plaintiff stated:

> "Your Honor, if we are getting down to whether this 555 pull and the other one that the other witness was talking about were made and sold before ours, we will admit it, and it will save an awful lot of time."

Exhibits D and E-3 were admitted in evidence [R. 44 and 45].

Although the court made no finding that the foregoing exhibits were prior art, and although a request for such finding was made, as shown in proposed Finding of Fact 9 [R. 23 and 24], there is no question but that these items are in fact prior art.

Door pulls and door knobs are designed and manufactured in great abundance. Among the various catalogs introduced at the trial, there is in this record physical Exhibits A-1 and F-1 to which reference is here made. These exhibits show many different pulls in various sizes and shapes. Without more, this court may properly conclude that no unusual or inventive talent is required to create a "new" knob or pull. The question with which this portion of the appeal is concerned is whether or not the plaintiff's "new" pull designed by Newton S. Leichter in fact required the exercise of invention, or was unobvious or otherwise met the standards of patentability as set forth in §103 of Title 35 of the United States Code which provides:

> "A patent may not be obtained though the invention is not identically disclosed or described as set forth

> in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains."

This section, of course, is directly applicable to design patents by virtue of the second paragraph of §171 of Title 35 of the United States Code, which provides:

> "The provisions of this title relating to patents for inventions shall apply to patents for designs, except as otherwise provided."

The appellant singles out for discussion and comparison at this time physical Exhibit E-3, and a patent drawing of Exhibit E-3 to be found at page I of the Appendix hereto. The appellant invites a direct comparison between Exhibit E-3 and the patent in suit [R. 46]:

1. Exhibit E-3 like the patented pull is made of *bar* material.
2. Exhibit E-3 like the patented pull is generally *rectangular*.
3. Exhibit E-3 like the patented pull is *concave* in transverse section.
4. Exhibit E-3 like the patented pull has a *downward arch*.

Thus Exhibit E-3, unlike the references found by the Examiner, has four out of five points of similarity with the patented pull. The only element lacking is a lens shaped opening. Exhibit E-3 has an overall similarity in appearance to the patented pull whereas the Heyer and Clayton pulls have no such general similarity.

Next, the appellant draws attention to physical Exhibit H, and also to a patent drawing of Exhibit H to be found at page II of the Appendix hereto. Appellant invites a comparison with the patented pull [R. 46]. Exhibit H has striking similarities to the patented pull:

1. It is made of *bar* material.
2. Not only is it generally *rectangular,* but the sides of this pull *bow outwardly* as do the sides of the patented pull.
3. The handle is *concave* in transverse section.
4. The pull has a *downward arch* nearly identical to that of the patented pull.

Again, Exhibit H, unlike the references found by the Examiner, bears a similarity of features that certainly can be rated 80 or 90 percent. The only feature lacking in Exhibit H is a lens shaped opening. Exhibit H has an overall similarity in appearance to the patented pull not even remotely approached by the Heyer and Clayton pulls.

Just how unobvious would it be to provide a lens shaped opening in Exhibit E-3 or Exhibit H? The appellant contends that a routine designer of furniture or cabinet hardware could do just such thing *without invention.* That such lens shaped openings have been provided in bar type pulls, reference is here made to physical Exhibit F which shows such opening occupying the central area of a pull between its mounting posts. It isn't unusual or strange to place curved holes in a knob or pull. See physical Exhibit A, physical Exhibit G and physical Exhibit C a patent drawing of which appears at page III of the Appendix hereto.

It is earnestly submitted that an ordinary designer of furniture or cabinet hardware having before him Exhibits E-3, H and F, for example, could *without invention* and without requiring any *unusual talent,* place a hole in Exhibit H or Exhibit E-3. The structure thereby resulting would differ immaterially and insignificantly from the patented pull, and surely would preclude invention in the patented pull.

6. Presumption of Validity Is Non-Existent.

Since the Examiner in the Patent Office failed to find the most pertinent references, the presumption of validity attaching to a patent under §282 of Title 35 no longer exists.

> *Jacuzzi Bros., Inc. v. Berkeley Pump Co., et al.* (9th Cir., 1951), 191 F. 2d 632.

7. Tests of Invention Are Strict.

A design *must* disclose inventive originality. Mere mechanical skill is no more sufficient to warrant the issuance of a design patent than the issuance of a mechanical patent.

> *Thabet Manufacturing Company v. Kool Vent Metal Awning Corporation of America* (6th Cir., 1955), 226 F. 2d 207.

A streamlined and pleasing appearance alone does not create patentability in the absence of invention. Thus in *Magarian v. Detroit Products Co.* (9th Cir., 1942), 128 F. 2d 544, this court stated at page 545:

> "It may readily be conceded, as appellant contends, that the design of the arm is streamlined and pleasing

in appearance; but this is insufficient in the absence of invention. Walker on Patents (Deller's Edition), Vol. 1, §129, p. 421; A. C. Gilbert Co. v. Shemitz, 2 Cir., 45 F. 2d 98, 99; Berlinger v. Busch Jewelry Co., Inc., 2 Cir., 48 F. 2d 812, 813. There was no invention here. The outline of the arm is perhaps a refinement over prior structures shown in the record, but that is all that can be said for it. The oval shape of the lenses is disclosed in both the Reynolds and the Costenbader patents. The Elliott patent as well as appellant's own earlier structure suggested the flanges at the outer rim of the plates and the position of the rivets fastening the flanges together."

In *Moore et al. v. C. R. Anthony Co.* (10th Cir., 1952), 198 F. 2d 607, at page 609 the court stated:

"Just as a mechanical patent must be more than 'new and useful', so must a design patent be more than new, original and ornamental. Both must contain that indefinable genius of invention. See Smith v. Whitman Saddle Co., 148 U. S. 674, 13 S. Ct. 768, 37 L. Ed. 606. The design must not only be new and pleasing enough to win acceptance in the market place, it must also distinctly add to the total knowledge of the particular field of design; it must be more than mere perfection of workmanship. Associated Plastics Companies, Inc. v. Gits Molding Corp., 7 Cir., 182 F. 2d 1000; Knickerbocker Plastic Co., Inc. v. Allied Molding Corp., 2 Cir., 184 F. 2d 652; Application of Johnson, 175 F. 2d 791, 36 C. C. P. A., Patents, 1175; In re Faustmann, 155 F. 2d 388, 33 C. P. A., Patents, 1065; Cf. Shaffer v. Armer, 10 Cir., 184 F. 2d 303."

In *Gold Seal Importers, Inc. v. Morris White Fashions, Inc.* (2nd Cir., 1941), 124 F. 2d 141, at page 142 the court stated:

> "The question remains whether the rearrangement of old elements with such minor variations as were necessary to produce the plaintiff's design involved some exceptional talent beyond the range of the ordinary designer. Each change in itself was simple: to make the shape more nearly oval, to deepen the folds on the front side and use a spiral rod for the central ornament, to duplicate the folds and ornament on the reverse side, to sink the mouth within the top edge and provide a zipper for closing. No one of these things would seem to involve exceptional talent beyond the skill of a designer. Whether the conception of a design combining all these changes into a unitary and pleasing whole requires a flash of 'inventive genius' rather than routine designing no formula can determine. In final analysis it depends upon the judgment of the judge or judges who have the last say. In our opinion Judge Galston was correct in ruling that the development of the patented design 'required nothing more than ordinary skill rather than creative art.' [38 F. Supp. 892]."

In *General Time Instruments Corporation v. United States Time Corporation* (2nd Cir., 1948), 165 F. 2d 853, at page 854 the court stated:

> "It is well settled that a design patent must be the product of invention if it is to be valid. Neufeld-Furst & Co. v. Jay-Day Frocks, 2 Cir., 112 F. 2d

715; *In re* Griffith, Cust. & Pat. App., 86 F. 2d 405. It will not suffice merely to show that the design is novel, ornamental, or pleasing in appearance. Gold Seal Importers v. Morris White Fashions, 2 Cir., 124 F. 2d 141. It must reveal a greater skill than that exercised by the ordinary designer who is chargeable with knowledge of the prior art. Zangerle & Peterson Co. v. Venice Furniture Novelty Mfg. Co., 7 Cir., 133 F. 2d 266; *In re* Eppinger, Cust. & Pat. App., 94 F. 2d 401. In short, the test is whether the design involved 'a step beyond the prior art requiring what is termed "inventive genius."' A. C. Gilbert Co. v. Shemitz, 2 Cir., 45 F. 2d 98, 99. So measured, plaintiff's patent must fail. Here there is no inventive skill. No more is shown than the modification and combination of existing clock designs to produce the one at issue. The changes are too slight to disclose the requisite originality and invention necessary to sustain a patent. Knapp v. Will & Baumer Co., 2 Cir., 273 F. 380. This is the talent of the adapter, rather than the art of the inventor. The patent was therefore properly held invalid."

In *Knickerbocker Plastic Co., Inc. v. Allied Molding Corp.* (2nd Cir., 1950), 184 F. 2d 652, at page 654 the court stated:

"So our court has held that 'a design patent must be the product of "invention," by which we meant the same exceptional talent that is required for a mechanical patent.' Nat Lewis Purses, Inc., v. Carole Bags, Inc. 2 Cir., 83 F. 2d 475, 476. See also

Friedley-Voshardt Co. v. Reliance Metal Spinning Co., D. C. S. D. N. Y., 238 F. 800, 801. Thus it is now too late to urge that an unstartling regrouping of old elements, which does not 'rise above the commonplace' or demonstrate 'originality which is born of the inventive faculty,' may be called 'invention' for the purposes of patent validity."

8. Commercial Success Does Not Weigh in Favor of the Patent.

Both plaintiff and defendant are in the hardware business and both sell substantial volumes of builders' hardware. It having been shown that plaintiff sold a volume of patented pulls, the District Court found in its Finding of Fact No. 4 [R. 31] that the plaintiff "has achieved commercial success." There is nothing in this record on appeal to show that this commercial success was in anyway unusual. There is nothing in this record to show that the patented pulls displaced any others. There is nothing in this record to show that this commercial success was immediate.

In any event commercial success is not and cannot be a substitute for invention. It cannot covert commonplace skill into invention.

Great Atlantic & Pacific Tea Co. v. Supermarket Equipment Corp. et al., 340 U. S. 147.

9. Application of the Rules Negates Patentability and Compels a Holding of Invalidity.

The drawer pull involved here is just another variant of a bar type pull. No element in it is new. It merely combines old features already known to the bar pull art. The design is not startling or unusual. A designer of

bar pulls certainly could be expected to put ornamental holes in pulls such as physical Exhibit E-3 or Exhibit H and as suggested by physical Exhibits A, C or G.

CONCLUSION.

In conclusion, the language of Justice Bradley in *Atlantic Works v. Brady,* 107 U. S. 192, and cited with approval by this court in *Oriental Foods, Inc. v. Chun King Sales, Inc., supra,* is particularly appropriate:

> "It was never the object of those laws to grant a monopoly for every trifling device, every shadow of a shade of an idea, which would naturally and spontaneously occur to any skilled mechanic or operator in the ordinary progress of manufacturers. Such an indiscriminate creation of exclusive privileges tends rather to obstruct than to stimulate invention. It creates a class of speculative schemers who make it their business to watch the advancing wave of improvement, and gather its foam in the form of patented monopolies, which enable them to lay a heavy tax upon the industry of the country, without contributing anything to the real advancement of the arts. It embarrasses the honest pursuit of business with fears and apprehensions of concealed liens and unknown liabilities to lawsuits and vexatious accountings for profits made in good faith."

The judgment of the District Court should be reversed on the issue of validity and the injunction sought should be granted.

Respectfully submitted,

FLAM AND FLAM,

By FREDERICK FLAM,

Attorneys for Defendant-Appellant.

E-3

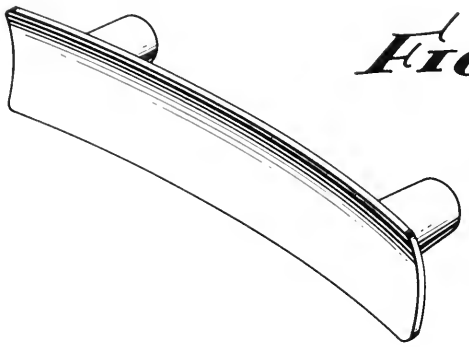


FIG. 1.

FIG. 2.

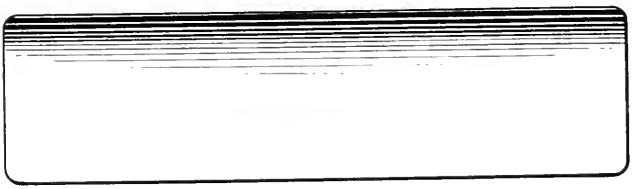


FIG. 3.

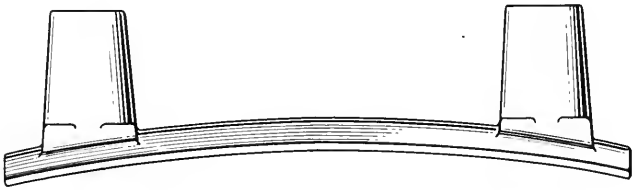
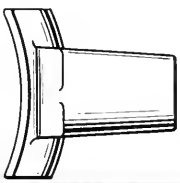


FIG. 4.



A

Fig. 1.

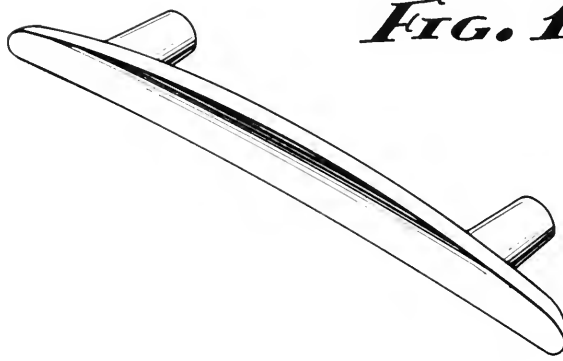


Fig. 2.

Fig. 3.

Fig. 4.

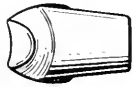


Fig. 1.

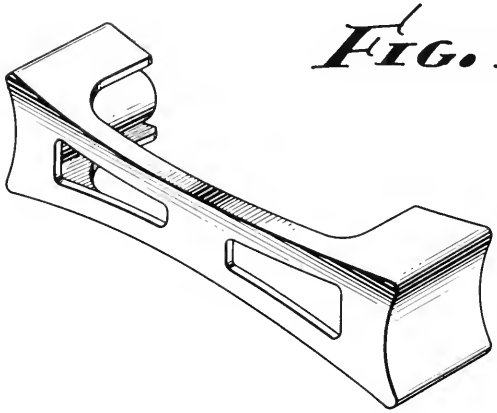


Fig. 2.

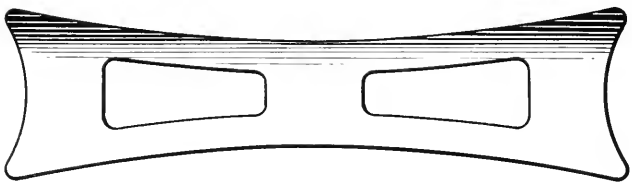


Fig. 3.

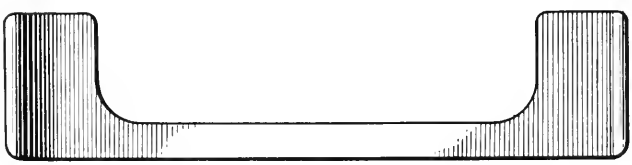


Fig. 4.

APPENDIX IV.

Exhibit		Record Page
1	Leichter Design Patent No. 182,602	38
5	Heyer Design Patent No. 169,357	38
6	Clayton Design Patent No. 180,684	38
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C	Bassick-Sack Pull No. 9459	41
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No. 16858

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAYBEE MANUFACTURING CORPORATION,

Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,

Appellee.

APPELLEE'S BRIEF.

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IN THE

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FOR THE NINTH CIRCUIT

JAYBEE MANUFACTURING CORPORATION,

Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,

Appellee.

APPELLEE'S BRIEF.

Summary of Argument.

I. THE PATENT IN SUIT IS VALID.

A. The presumption of validity of the patent in suit has not been overcome by Appellant.

B. The District Court had before it adequate evidence to support the holding of validity.

C. The slavish imitation of the design of the patent by Appellant is indicative of the advance made by Appellee.

D. The design of the patent is new, original and ornamental.

II. The District Court Erred in Holding That the Patent Was Not Infringed.

A. The question of infringement of the patent by the accused device is before this Court.

B. The question of infringement is a question of law.

C. The addition of a modifying feature to the infringing device does not avoid infringement.

D. Plaintiff's infringement was of a most flagrant nature.

III. The District Court's Refusal to Grant Relief Under Appellant's Counterclaim for Declaratory Relief Was Well Founded.

ARGUMENT.

I.

The Patent in Suit Is Valid.

A. The Presumption of Validity of the Patent in Suit Has Not Been Overcome by Appellant.

Not a single one of the references applied by the Examiner during the prosecution of the application which issued as United States Design Letters Patent No. 182,602, Exhibit 1 [R. 46], was anticipatory of the basic concept of Appellee's assignor.

During the prosecution of the patent in issue, the Examiner applied two references, namely, United States Design Letters Patent No. 169,257, Exhibit 5 [R. 46], and United States Design Letters Patent No. 180,684, Exhibit 6 [R. 49].

Design Patent No. 169,257, Exhibit 5, discloses a pull which is:

(1) Made of bar material;

(2) Concave in transverse cross section;

(3) Substantially rectangular in edge elevation, Figure 4;

(4) Provided with a downward arch at its extremities.

The design of the pull of Design Patent No. 180,684, Exhibit 6, is more pertinent to Appellee's design concept than the prior art relied upon by Appellant, because this design:

(1) Is substantially rectangular;

(2) Has a pronounced upward arch;

(3) Has an elongated central opening;

(4) Has mounting studs adjacent its extremities.

Appellant has assumed that various exhibits, namely Exhibit E-3, Exhibit H and Exhibit C (Appendices 1-3 to Appellant's Br.), which were not cited by the Examiner during the prosecution of the application from which the patent in suit issued, have destroyed the customary presumption of validity afforded an issued patent by the Courts.

A comparison of the prior art cited by the Examiner with that relied upon by Appellant is conducive to the belief that none of the prior art relied upon by Appellant is as pertinent as that cited by the Examiner. The pull of Exhibit E-3:

(1) Is predominantly rectangular;

(2) Presents a massive aspect;

(3) Incorporates no opening;

(4) Is of uniform width from one extremity to the other thereof;

(5) Has an arcuate top and bottom.

The pull, Exhibit H:

(1) Is substantially illipsoidal;

(2) Is of exaggerated length;

(3) Lacks the central opening;

(4) Does not incorporate the contrast of the ellipsoidal opening with the substantially bowed rectangle of Appellee's design;

(5) Has an arcuate top and bottom.

Exhibit C can add nothing to Exhibits E-3 and H other than the provision of a pair of substantially rectangular openings separated by an intermediate bridge.

It is self-evident from the physical exhibits themselves and from the analysis of the drawings thereof attached as Appendices 1-3 to Appellant's Brief, that none of the designs of Exhibits E-3, H and C is as pertinent as the prior art cited by the Examiner during the prosecution of the application from which the patent in issue matured. It is well established law that the presumption of validity afforded a patent by the Courts is overcome only when art more pertinent than that applied by the Examiner is submitted by the defendant as a basis for invalidation of the patent.

In *Jacuzzi Bros. v. Berkeley Pump Co.* (1951), 191 F. 2d 632, 91 U. S. P. Q. 24, 27, this Court said:

> "But further, a great many of the patents, which were brought to light in this lawsuit and considered by the Trial Court, had not been previously considered by the Patent Office. *Even one prior art reference, which has not been considered by the Patent Office, may overthrow the presumption of validity,* and, when the most pertinent art has not been brought to the attention of the administrative body, the presumption is largely dissipated. Such is the case here."

The analysis hereinabove of the prior art relied upon by Appellant is indicative of the fact that it is actually less pertinent than that cited by the Examiner and thus, in accordance with the decision cited, does not destroy the presumption of validity afforded the patent in issue.

B. The District Court Had Before It Adequate Evidence to Support the Holding of Validity.

All of the prior art relied upon by Appellant in support of its contention of invalidity of the patent in issue was before the District Court and was considered in conjunction with the testimony of witnesses of Appellant pertinent thereto. It is submitted that the judgment of validity of the patent in issue is well founded on the evidence before the District Court and that there was no clear error which would warrant the reversal of the holding of the District Court in this regard.

> "It is established, of course, that in a patent case the findings of fact of the district court—unless clearly erroneous—should not be disturbed." *Modern Products Supply Co. v. Drachenberg,* 152 F. 2d 203, 207, 68 U. S. P. Q. 10, 14 (C. A. 6).

C. The Slavish Imitation of the Design of the Patent by Appellant Is Indicative of the Advance Made by Appellee.

It has been repeatedly held that a defendant's imitation of a patented device or structure can be taken as evidence of invention as stated by Judge Hough in *Kurtz v. Belle Hat Lining Co.* (2 Cir.), 280 Fed. 277, 281:

> "The imitation of a thing patented by a defendant, who denies invention, has often been regarded, perhaps especially in this circuit, as conclusive evidence of what the defendant thinks of the patent, and persuasive of what the rest of the world ought to think."

See also:

Otto v. Koppers Co. Inc. (C. A. 4, 1957), 114 U. S. P. Q. 188;

Robert W. Brown & Co., Inc. v. DeBell (C. A. 9, 1957), 113 U. S. P. Q. 172.

A visual comparison of the alleged infringing pull manufactured by Appellant with the pull shown in the patent in issue and the pull manufactured by Appellee in accordance with said patent is illustrative of two facts:

(1) That Appellant's only design source was the pull of Appellee's design; and

(2) Appellant copied Appellee's design in a most slavish and non-creative manner.

D. The Design of the Patent Is New, Original and Ornamental.

The analysis of the prior art cited by the Patent Office and the prior art relied upon by Appellant in attempting to overcome the presumption of validity and invalidate the patent in issue is illustrative of the fact that the design of the patent in issue was new, novel and ornamental and constituted an inventive contribution by Appellee's assignor.

As stated by Judge Yankwich in *Laskowitz v. Marie Designer, Inc.* (D. C. S. D. Cal.), 119 Fed. Supp. 541, 544:

> "Patentability exists if the design looked at as a whole (*le tout ensemble*) gives a pleasing impression. Of course, the result must come from the exercise of the inventive faculty. If these elements are present it is not material that the design may embody a regrouping of familiar forms and decoration."

II.

The District Court Erred in Holding That the Patent Was Not Infringed.

A. The Question of Infringement of the Patent by the Accused Device Is Before This Court.

In numerous cases it has been held that an appeal from the decision of the Lower Court brings the entire record before the Appellate Court. In *Guiberson Corp. v. Equipment Engineers,* 252 F. 2d 431, 432 (5 Cir. 1958), considering whether the question of validity of a patent was before it, the Appellate Court held as follows:

> "We, however, agree that the question of the validity of the patent is before us not because of the so-called cross appeal but because plaintiff's appeal from the decision dismissing its suit brought the whole record up and all questions going to the correctness of the judgment are properly before us."

See also:

Marchus v. Druge, 136 F. 2d 602 (9 Cir. 1943);

Graham v. Cockshutt Farm Equipment, 256 F. 2d 358, 359 (5 Cir. 1958).

B. The Question of Infringement Is a Question of Law.

It has been held in this circuit that where there is no dispute as to the evidentiary facts, and the record and exhibits are clear, the question of infringement resolves itself into a question of law.

Kwikset Locks v. Hillgren, 210 F. 2d 483 (9 Cir. 1954).

Therefore, this Court may determine whether the judgment of the District Court that no infringement of

the patent in issue had occurred was well founded. The issue of non-infringement is susceptible to *de novo* re-examination by this Court, since the entire record and all elements of the judgment of the Lower Court are subject to re-evaluation by this Court.

C. The Addition of a Modifying Feature to the Infringing Device Does Not Avoid Infringement.

A simple comparison of the device of the design of the patent in issue with the design of the alleged infringing pull should be sufficient to convince this Court that the Lower Court was clearly in error in its holding of non-infringement. Since the Lower Court held the patent in suit valid it is submitted that, on the evidence before it, it should have held the patent infringed. A consideration of the common design elements of the design of the patent in issue and the design of the alleged infringing device incontrovertibly establishes identity of the two designs, as follows:

(1) Both the design of the patent and the design of the alleged infringing device are constituted by elongated bodies with substantially square ends and bowed-out sides;

(2) Both bodies have dished or concave upper surfaces;

(3) Both bodies incorporate centrally located, substantially ellipsoidal openings which terminate inwardly of the mounting bosses for the bodies;

(4) Both bodies have downwardly curving bottom portions;

(5) The top edges of both bodies are straight.

In addition to incorporating every design element of the patent in issue, the alleged infringing device has had a pair of semi-circular cross bars incorporated therein intermediate the extremities of the elongated opening in the body. Appellant has evidently attempted, by the incorporation of this modification, to avoid the onus of a charge of infringement. However, it has been repeatedly held that the addition of an element or improvement to an infringing device will not avoid a charge of infringement if the exclusive features of the patent in suit have been adopted.

In *Jonus v. Roberti,* 7 F. 2d 563 (9 Cir. 1925), this Court held as follows:

> "But an inventor cannot be deprived of the benefit of the idea which he has disclosed to the public by improvements subsequently made by another in carrying forward the art."

Similarly, in *Long v. Dick,* 38 Fed. Supp. 214, 219 (D. C., S. D. Cal. C. D. 1941), the Court considered the same problem in the following language:

> "An addition which results in no substantial change of character merely for the purpose of avoiding the patent does not avoid infringement."

See also:

Solex Laboratories v. Graham, 165 Fed. Supp. 428 (D. C. S. D. Cal.).

D. Plaintiff's Infringement Was of a Most Flagrant Nature.

Even the most superficial comparison of the alleged infringing device with the drawings of the patent in suit and with the actual embodiment of the design of the patent in suit manufactured by Appellee should be sufficient to convince this Court that the design of the patent in suit has been willfully appropriated by the Appellant. As a matter of fact, the pull manufactured by Appellant and the pull manufactured by Appellee are of identical dimensions and configuration.

The criterion of infringement of a design patent is whether the similarity between the design of the patent in suit and the design of the alleged infringing device is such as to confuse the eye of the casual purchaser and to lead said purchaser into thinking that the infringing device is the device of the patent in suit. This test was clearly stated by the Supreme Court of the United States in *Gorham Company v. White,* 14 Wall. 511, in the following language:

> "Plainly, it must be the sameness of appearance, and mere difference of lines in the drawing or sketch, a greater or lesser number of lines, or slight variations in configuration . . . will not destroy the substantial identity."

III.

The District Court's Refusal to Grant Relief Under Appellant's Counterclaim for Declaratory Relief Was Well Founded.

Appellant is not entitled to a prospective injunction. The burden of Appellant's argument relating to the refusal of the Lower Court to grant an injunction under Appellant's counterclaim is to the effect that the Appellee should be restrained from asserting that the patent in issue is or ever was infringed by Appellant or its customers.

It is manifestly not the function of injunctive relief to restrain an action which has not been threatened. That is, there is no evidence in the record to indicate that Appellee intends to charge Appellant with the infringement of the patent in suit because of the manufacture of the alleged infringing pulls.

If Appellee were to charge Appellant with infringement of the patent in issue because of the manufacture of the pulls which the Lower Court held would not constitute infringement, then the Appellant would have an appropriate basis for seeking the jurisdiction of the Court and requesting injunctive relief. However, in the absence of a threat of such charges of infringement, the issuance of an injunction by the Lower Court would constitute an attempt to forestall an action which has not even been threatened. The mere fact that, prior to the adjudication of the patent in issue, Appellee charged Appellant and its customers with infringement in two letters, does not establish a tendency or intent upon the

part of Appellee to assert infringement of the patent in suit against pulls manufactured by Appellant which have been held not to infringe the patent in suit.

The undesirability of injunctive relief of a prospective nature in the absence of an imminent threat of harm was considered by the New York Court of Appeals in *Electrolux Corp. v. Val-Worth Inc.,* 123 U. S. P. Q. 175, 179. in the following language:

> "The second question results from the use of the word 'famous' in the telecasts prior to January 12. 1953. Even if we assume that both courts deemed it misleading. we observe that there is no question but that this practice was discontinued on television after protest by plaintiff about six months prior to the commencement of the action. The Appellate Division took the view that this discontinuance six months prior to the commencement of the action and the absence of any indication in the record that defendants intend to resume the practice render an injunction unnecessary and inappropriate. We are in accord with this result, for the extraordinary relief of an injunction is protection for the future and is not proper unless the injury is imminent. . . ."

There is no proof in the record that, after the letters written in April, 1959, Exhibits N-1 and N-2 [R. 51-52], the Appellee has ever threatened the Appellant or its customers in any way because of the manufacture of the alleged infringing device. Therefore, the issuance of an injunction against the Appellee would appear

to be a nugatory act in the absence of an imminent threat that the Appellee intended to charge infringement of its patent by Appellant or its customers.

Conclusion.

It is respectfully submitted that the District Court properly held that the patent in issue is valid and that no relief should be granted to Appellant in injunctive form against charges of infringement made by Appellee against Appellant or its customers.

However, since the Lower Court held the patent in issue valid, its decision that the alleged infringing device did not infringe the patent in suit was clearly erroneous and subject to reversal by this Court. The prior art upon which the Appellant relies in an attempt to overcome the presumption of validity afforded the patent is completely inadequate and no more pertinent than the file wrapper art applied during the prosecution of the application which resulted in the patent in issue.

Therefore, it is respectfully submitted that the judgment of the District Court should be sustained on the issue of validity and reversed on the holding of non-infringement of the patent in suit.

Respectfully submitted,

THOMAS P. MAHONEY,

Attorney for Appellee.

No. 16858

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAYBEE MANUFACTURING CORPORATION,

Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,

Appellee.

APPELLANT'S REPLY BRIEF.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAYBEE MANUFACTURING CORPORATION,

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vs.

AJAX HARDWARE MANUFACTURING CORPORATION,

Appellee.

APPELLANT'S REPLY BRIEF.

Summary of Argument.

1. Appellant is entitled to injunctive relief restraining appellee from threatening appellant's customers with infringement suits.

2. The question of infringement is not before this Court.

3. The patent in suit is invalid by any standard.

ARGUMENT.

1. Appellant Is Entitled to Injunctive Relief Restraining Appellee From Threatening Appellant's Customers With Infringement Suits.

The District Court finally held the patent to be not infringed. Therefore, on the authority of Section 2208 of the United States Code, the Supreme Court case of *Kessler v. Eldred,* 206 U. S. 285, and *Vermont Structural Slate Co. v. Tatko Brothers Slate Co.,* 253 F. 2d 29, all discussed in appellant's opening brief, it is manifestly clear that appellant has, in the words of *Kessler v. Eldred,* the "unquestioned right" to an injunction. Appellee cited nothing in any way detracting from these authorities.

In a desperate effort to have this Court overrule that clear authority, appellee cites the New York State Court of Appeals in *Electrolux Corp. v. Val-Worth, Inc.* Of course this was not a patent case, and in any case can hardly temper the rule of *Kessler v. Eldred* for patent cases. The New York Court refused to grant an injunction to an applicant where the offensive practice for which the suit was brought, was discontinued six months prior to the institution of the suit. The analogy attempted to be drawn is clearly infirm. The reason is this: The record in this case [R. 6] shows that the complaint was filed April 7, 1959. *Just one week later* (and as a matter of fact before appellant had an opportunity to answer the complaint) appellee wrote threatening letters to two customers of appellant. Exhibits N-1 and N-2 bear the date of April 16, 1959, as clearly shown in the record [R-51 and 52]. Surely this nullifies any force or effect of the case of *Electrolux Corp. v. Val-Worth, Inc.*

Of course it is appropriate for this Court to consider equities in deciding upon the propriety of an injunction. Appellee's threats following on the heels of this suit undermines any equity in appellee's favor. What excuse did appellee have to write such letters? Was appellant unwilling or unable to answer for its customers' infringements, if any? Was appellant inconveniently located in a district far removed from appellee's domicile? Did appellee honestly intend to start suit against appellant's customers? The record speaks clearly on this issue, and points unmistakably to the issuance of the injunction not only as a matter of right but as a matter of equity.

2. The Question of Infringement Is Not Before This Court.

A party who has not appealed has no right to urge errors; he has acquiesced in the judgment. Appellee may urge any matter in the record in *support* of the judgment. He may not *attack* it. In *Alexander v. Cosden Pipe Line Co.,* 290 U. S. 484, Mr. Justice Van Devanter stated at page 487:

> ". . . The defendant alone petitioned for a review here. In this situation the plaintiff is not entitled to be heard in opposition to the parts of the decision . . . which were adverse to it, . . . but only in *support* of the parts which were in its favor. As to the former, it has acquiesced and become concluded by not seasonably petitioning for review." (Emphasis added.)

An attack on the lower court's holding of non-infringement is obviously not necessary to *support* the holding of validity. Hence, appellee cannot be heard on the issue

of infringement. In any case there is no record to support any such argument. Not even the accused device is in the record.

In *Guiberson Corp. v. Equipment Engineers,* and the other cases cited by appellee, the lower court held the patent valid but not infringed, and the *plaintiff,* not the defendant, appealed. The defendant was entitled to *support* the judgment by arguments *based on the record* that the patent was invalid. An argument by appellee here that the patent was infringed doesn't support the judgment of validity of the lower court. It has nothing to do with it.

Appellee had its day in court on the question of infringement. An appeal is not a trial *de novo.*

3. The Patent in Suit Is Invalid by Any Standard.

Appellee's argument that "the prior art relied upon by appellant . . . is actually less pertinent than that cited by the Examiner" is unconvincing.

The statement that "testimony of witnesses" supports the District Court's finding of validity goes far beyond the present record. The innuendo is furthermore false and misleading.

Appellee's argument regarding appellant's alleged imitation of the patented design is not only unsupported by the record, but an open disregard of the final judgment of the court below.

The recent decision of this Court of Appeals in *Patriarca Mfg., Inc. et al. v. Sosnick et al.,* 278 F. 2d 389, is certainly appropriate in this appeal. The following statement of Circuit Judge Merrill is pertinent (p. 391):

> "One may well agree that the patented showcase presents a more pleasing appearance and one more

calculated to tempt the customer. One may well conclude that, artistically and from a merchandising point of view, the patented showcase marks an advance in matters of design. Not every advance, however, is the result of creative invention. More often it can be credited to the normal progress which results when discriminating taste and judgments are applied to that which has already been discovered or created. . . .

"Appellants have happily combined matters of prior art into a pleasing assemblage. They may be credited with good taste and a sound sense of proportion, but not with creative invention."

Conclusion.

It is earnestly submitted that the judgment of the District Court should be reversed on the issue of validity and that in any event the injunction sought should be granted.

Respectfully submitted,

FLAM AND FLAM,

By FREDERICK FLAM,

Attorneys for Appellant.

No. 16858

United States
Court of Appeals
for the Ninth Circuit

JAYBEE MANUFACTURING CORPORATION,
Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,
Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California, Central Division

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—6-9-60

No. 16858

United States
Court of Appeals
for the Ninth Circuit

JAYBEE MANUFACTURING CORPORATION,
Appellant,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION,
Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California, Central Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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* Page numbering appearing at foot of page of original certified Transcript of Record.

In the United States District Court, Southern District of California, Central Division

Civil Action No. 316-59 WB

AJAX HARDWARE MANUFACTURING CORPORATION, Plaintiff,

vs.

JAYBEE MANUFACTURING CORPORATION, Defendant.

COMPLAINT FOR INFRINGEMENT OF UNITED STATES LETTERS PATENT Des. No. 182,602

Now comes the plaintiff and for its cause of action avers:

I.

This action arises under the patent laws of the United States of America U.S.C. Title 35, as amended, as hereinafter more fully appears.

II.

Plaintiff, Ajax Hardware Manufacturing Corporation, is a corporation organized and existing under the laws of the State of California and having its principal place of business at 4351 Valley Boulevard, Los Angeles 32, California. [2]

III.

Defendant, Jaybee Manufacturing Corporation, is a corporation organized and existing under the laws of the State of California, and having its principal place of business at 566 North San Fernando Road, Los Angeles, California.

IV.

On April 22, 1958, United States Letters Patent Des. No. 182,602 was duly issued for a term of fourteen years to plaintiff Ajax Hardware Manufacturing Corporation for a design for a handle or similar article by virtue of mesne assignment from the applicant Newton S. Leichter, and ever since said date said plaintiff has been and now is the owner of said Letters Patent. Profert of said Letters Patent is hereby made.

V.

Since the issuance of said Letters Patent Des. No. 182,602, and within six years last past, the defendant, as plaintiff is informed and believes and therefore avers, has been and still is infringing said Letters Patent Des. No. 182,602, in the Southern District of California, and elsewhere, during the term of said Letters Patent, without the license of plaintiff, by causing the design secured by such design patent, or a colorable imitation thereof, to be applied to handles or similar articles for the purpose of sale, and selling or exposing for sale, or causing to be sold or exposed for sale, handles or similar articles to which such design or a color-

able imitation thereof, without the license of plaintiff, has been applied, and will continue to do so unless enjoined by this Court, and has derived unlawful gains and profits [3] from such infringing acts which plaintiff would otherwise have received, and defendant has by such infringement caused damage to plaintiff which will be irreparable unless defendant is enjoined from further infringement of said Letters Patent Des. No. 182,602.

VI.

Plaintiff has caused the required statutory notice to be placed on handles or similar articles manufactured and sold under said Letters Patent Des. No. 182,602.

VII.

Plaintiff has built up a substantial business in the manufacture and sale of handles or similar articles made in accordance with and embodying the invention of said Letters Patent Des. No. 182,602. Said handle or similar article has been recognized by the public as a marked advance in the art. It quickly became popular and in great demand, which popularity and demand have been continuous to date. Plaintiff is informed and believes that the defendant did not independently create the infringing design, but copied the commercial product of plaintiff embodying the invention of that patent.

VIII.

The infringement by the defendant has been deliberate, willful and intentional and has irreparably injured the plaintiff. [4]

Wherefore, plaintiff respectfully prays judgment against the defendant as follows:

1. For a preliminary and final injunction against further infringement by defendant and those controlled by defendant.
2. For damages sustained by plaintiff by reason of said defendant's infringement.
3. That the damages be trebled in view of the deliberate, willful and intentional infringement.
4. For the total amount of the profits made by the defendant on account of said infringement.
5. For the minimum amount of $250.00 for said infringement.
6. For attorneys' fees.
7. For plaintiff's costs and disbursements herein.
8. For such other and further relief as may appear just and equitable.

AJAX HARDWARE MANUFACTURING CORPORATION,
/s/ By NORMAN D. LOUIS,
President,
Plaintiff.

HUEBNER & WORREL,
HERBERT A. HUEBNER,
GEORGE H. HALBERT,
ALBERT L. GABRIEL,
/s/ By GEORGE H. HALBERT,
Attorneys for Plaintiff. [5]

Duly Verified. [6]

[Endorsed]: Filed April 7, 1959.

[Title of District Court and Cause.]

ANSWER

Comes now Jaybee Manufacturing Corporation and for answer to the complaint of plaintiff alleges as follows:

I.

Answering paragraphs I, II, III and IV of said complaint, defendant admits the allegations thereof but traverses the legal conclusion that Design Patent No. 182,602 was duly or otherwise properly issued.

II.

Defendant denies each and every allegation of paragraphs V, VI, VII and VIII.

Affirmative Defenses

III.

Further answering said complaint, defendant alleges that said Design Patent No. 182,602 is invalid, particularly if construed sufficiently broadly to include any article manufactured or sold by defendant for each and [8] every one of the following reasons, among others:

A. The United States Patent Office Examiner in charge of the application that resulted in said patent erred in allowing said application because the subject matter thereof did not involve invention but only the skill of workers versed in the arts of design.

B. Newton S. Leichter was not the inventor of the subject matter of said application.

C. Before the alleged invention thereof by the said Leichter, the alleged invention was known or used by others in this country or patented or described in printed publication, identified as follows:

"Polynesian Artifacts", Second Edition, published in Wellington, New Zealand in the year 1953 by The Polynesian Society, Inc.

"Furniture for Modern Interiors" by Mario Dal Fabbro, published in 1954 by Reinhold Publishing Corporation of New York, New York.

Catalog of Faultless Furniture Hardware, division of Faultless Caster Corporation of Evansville, Indiana.

And other publications and patents, the numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

D. More than one year prior to the date of said application for patent, the invention was patented, or described in a printed publication or in public use or on sale in this country as follows:

"Polynesian Artifacts", Second Edition, published in Wellington, New Zealand in the year 1953 by the Polynesian Society, Inc.

"Furniture for Modern Interiors" by Mario Dal Fabbro, published in 1954 by Reinhold Publishing Corporation of New York, New York.

Catalog of Faultless Furniture Hardware, division of [9] Faultless Caster Corporation of Evansville, Indiana.

And other publications and patents, the numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

E. The alleged invention was described in patents granted on applications for patents and others, filed in the United States before the alleged invention thereof by the said Leichter, the exact numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

IV.

Defendant alleges that no article manufactured or sold by it infringes said Design Patent No. 182,602, and that no article manufactured or sold by it appropriates the design shown in said Design Patent No. 182,602.

Counterclaim for Declaratory Judgment

Comes now Jaybee Manufacturing Corporation, and for counterclaim against plaintiff alleges as follows:

I.

Defendant, Jaybee Manufacturing Corporation, is a corporation organized and existing under the laws

of the State of California, and having its principal place of business at 566 San Fernando Road, Los Angeles 65, California.

II.

Plaintiff, Ajax Hardware Manufacturing Corporation, is a corporation organized and existing under the laws of the State of California and having its principal place of business at 4351 Valley Boulevard, Los Angeles 32, California. [10]

III.

This is a counterclaim for declaratory relief; and the jurisdiction of this court depends upon Section 2201 and 2202 of Chapter 151 of Title 28 of the United States Code; an actual controversy between defendant, Jaybee Manufacturing Corporation, and plaintiff, Ajax Hardware Manufacturing Corporation, exists as to alleged infringement by defendant of United States Design Patent No. 182,602, issued on April 22, 1958, and which plaintiff is alleged to be the owner.

IV.

Defendant is in the business of manufacturing and selling hardware throughout the United States, and defendant has at substantial cost and expense built up a valuable goodwill in connection with its business. Plaintiff has issued notices to the trade and to customers of defendant that the said plaintiff intends to prosecute the customers of defendant under said Design Patent No. 182,602 because of

resale by said customers of goods manufactured and sold by defendant, whereas the goods manufactured and sold by defendant are not infringements of said Design Patent No. 182,602.

V.

At no time has defendant or its customers infringed said Design Patent No. 182,602.

VI.

Said United States Design Patent No. 182,602, issued April 22, 1958 is invalid, particularly if construed sufficiently broadly to include any article manufactured or sold by defendant for each and every one of the following reasons, among others:

A. The United States Patent Office Examiner in charge of the application that resulted in said patent erred in allowing said application because the subject matter thereof did not involve invention but only the skill of workers versed in the arts of design.

B. Newton S. Leichter was not the inventor of the subject matter of said application.

C. Before the alleged invention thereof by the said Leichter, the alleged invention was known or used by others in this country or patented or [11] described in printed publications, identified as follows:

"Polynesian Artifacts", Second Edition, published in Wellington, New Zealand in the year 1953 by the Polynesian Society, Inc.

"Furniture for Modern Interiors" by Mario Dal Fabbro, published in 1954 by Reinhold Publishing Corporation of New York, New York.

Catalog of Faultless Furniture Hardware, division of Faultless Caster Corporation of Evansville, Indiana.

And other publications and patents, the numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

D. More than one year prior to the date of said application for patent, the invention was patented, or described in a printed publication or in public use or on sale in this country as follows:

"Polynesian Artifacts", Second Edition, published in Wellington, New Zealand in the year 1953 by the Polynesian Society, Inc.

"Furniture for Modern Interiors" by Mario Dal Fabbro, published in 1954 by Reinhold Publishing Corporation of New York, New York.

Catalog of Faultless Furniture Hardware, division of Faultless Caster Corporation of Evansville, Indiana.

And other publications and patents, the numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

E. The alleged invention was described in patents granted on applications for patents and others, filed in the United States before the alleged inven-

tion thereof by the said Leichter, the exact numbers, dates and names of which are at present unknown to defendant, but which numbers, dates and names, [12] the said defendant prays leave to insert in this answer by amendment thereof when ascertained.

Wherefore defendant prays:

a. That the complaint be dismissed.

b. That this court declare the rights of defendant and plaintiff as to the controversy set forth in this counterclaim.

c. That this court declare that articles manufactured and sold by defendant and alleged by plaintiff to infringe said Design Patent No. 182,602 do not infringe said patent.

d. That this court declare that Design Patent No. 182,602 is invalid.

e. That this court grant a preliminary and final injunction enjoining and restraining plaintiff, its officers, agents, servants, employees and attorneys, and those in active concert or participating with it from asserting, contending, claiming or alleging that said Design Patent No. 182,602 is or ever was infringed by defendant, Jaybee Manufacturing Corporation, or its customers, on account of the manufacture and sale by said defendant, or by the resale by its customers of the accused articles.

f. That this court restrain plaintiff during the pendency of this action from circularizing, writing, or any other manner contacting the trade or customers of defendant, Jaybee Manufacturing Corpo-

ration, with respect to said Design Patent No. 182,602.

g. That the court adjudge and decree that defendant shall have costs of suit incurred, reasonable attorneys' fees, and other relief as the court may seem proper under the circumstances.

FLAM AND FLAM,
FREDERICK FLAM,
/s/ By FREDERICK FLAM,
Attorneys for Defendant. [13]

Duly Verified. [14]

Affidavit of Service by Mail Attached. [15]

[Endorsed]: Filed May 18, 1959.

[Title of District Court and Cause.]

ANSWER TO COUNTERCLAIM

Comes now the plaintiff and answers the counterclaim set forth in the Answer of the defendant as follows:

1.

Plaintiff admits the allegations contained in Paragraph I of said counterclaim.

2.

Plaintiff admits the allegations contained in Paragraph II of said counterclaim.

3.

Plaintiff admits the allegations contained in Paragraph III of said counterclaim.

4.

Plaintiff admits that defendant is in the business of manufacturing and selling hardware throughout the United States; plaintiff having no information or belief upon the allegations set forth [16] in Paragraph IV of said counterclaim that defendant has at substantial cost and expense built up a valuable goodwill in connection with its business sufficient to enable it to answer said allegations, denies the same; plaintiff admits that it has issued notices to two customers of defendant as alleged in said Paragraph IV; and except as herein specifically admitted, plaintiff denies each and every allegation of said Paragraph IV.

5.

Plaintiff denies each and every allegation contained in Paragraph V of said counterclaim.

6.

Plaintiff denies each and every allegation contained in Paragraph VI of said counterclaim.

Wherefore, plaintiff respectfully renews the prayer set forth in its complaint herein, and fur-

ther prays that defendant's counterclaim be dismissed, with costs and attorneys' fees.

Dated, Los Angeles, California, June 1, 1959.

HUEBNER & WORREL,
HERBERT A. HUEBNER,
GEORGE H. HALBERT,
ALBERT L. GABRIEL,
/s/ By GEORGE H. HALBERT,
Attorneys for Plaintiff. [17]

Duly Verified. [18]

Affidavit of Service by Mail Attached. [19]

[Endorsed]: Filed June 4, 1959.

MEMORANDUM FROM JUDGE FRED KUNZEL

Los Angeles
California
January 13, 1960

To: Huebner & Worrel
George N. Halbert, Esq.
610 South Broadway
Los Angeles 14, California
Flam & Flam
Frederick Flam, Esq. and
John Flam, Esq.
2978 Wilshire Boulevard
Los Angeles, California

Re: Civil No. 316-59-K
Ajax Hardware Manufacturing Corporation
vs. Jaybee Manufacturing Corporation

Gentlemen:

As was announced at the conclusion of the trial in the above-entitled action, I did not feel that there was a serious question on infringement. It is my view that the alleged infringing drawer pull did not closely resemble the patented pull.

The question of the validity of the design patent presents a much closer question from two standpoints—whether the design was anticipated by prior art and whether Leichter was the sole inventor, however, I will find that the patent is valid and that Leichter was the inventor.

Plaintiff will prepare findings of fact, conclusions of law and judgment in accordance with the above.

FRED KUNZEL,
U. S. District Judge.

Blind copy to: John E. Childress, Clerk of the U. S. District Court, Los Angeles, California. [20]

In the United States District Court, Southern District of California, Central Division

Civil Action No. 316-59-FK

AJAX HARDWARE MANUFACTURING CORPORATION, Plaintiff,

vs.

JAYBEE MANUFACTURING CORPORATION, Defendant.

JAYBEE MANUFACTURING CORPORATION, Cross-plaintiff,

vs.

AJAX HARDWARE MANUFACTURING CORPORATION, Cross-Defendant.

OBJECTIONS TO PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

Defendant, Jaybee Manufacturing Corporation, hereby objects to the proposed Findings of Fact,

Conclusions of Law and Judgment filed by the plaintiff herein, on each of the following grounds:

1. The Findings of Fact proposed by plaintiff reveal no understanding or analysis of the evidence, and they fail to penetrate beneath the ultimate conclusions of fact. The Findings of Fact as proposed by plaintiff are based upon the pleadings and not upon the evidence. [21]

2. The Findings of Fact proposed by plaintiff are indefinite.

3. The Findings of Fact proposed by plaintiff are inadequate in that they contain no finding as to the allegation of willfulness, no finding as to the allegation of issuance of threats to defendant's customers, no finding of fact as to prior art, no finding of fact as to infringement.

4. Plaintiff's proposed Finding No. 4 is inaccurate as to the question of commercial success.

5. Plaintiff's proposed Finding No. 7 is improper in that proper marking is a question of law; plaintiff's proposed finding is defective for failure to set forth specifically the facts upon which such legal conclusion might be based.

6. Plaintiff's proposed Finding No. 8 is improper in that the conclusion of invention by the named inventor is one of law; plaintiff's proposed Finding No. 8 is defective in that it fails to set forth facts upon which a legal conclusion might be based.

7. The Conclusions of Law proposed by plaintiff are inadequate in that they fail to present the

legal conclusions as to the defenses raised by defendant, and that they fail to decide the questions raised in defendant's counterclaim, and particularly in that they fail to indicate that defendant is entitled to a declaration of rights under §2201 of Title 28 of the United States Code, and to a judgment and injunction on its counterclaim pursuant to §2202 of Title 28 of the United States Code.

8. The Judgment proposed by plaintiff is defective and inadequate in that it fails to give costs of suit to the defendant, which is the prevailing party.

9. The Judgment proposed by plaintiff is defective because it fails to dismiss the plaintiff's complaint.

10. The Judgment proposed by plaintiff is defective because it erroneously and improperly dismisses the defendant's counterclaim which is good and valid. [22]

11. The Findings of Fact, Conclusions of Law and Judgment proposed by plaintiff are inadequate, defective and improper, particularly for lack of conformance to the Findings of Fact, Conclusions of Law and Judgment proposed by defendant, a copy of which is appended hereto.

January 21, 1960.

FLAM AND FLAM,
/s/ By FREDERICK FLAM,
Attorneys for Defendant. [23]

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This cause having come on for trial upon the merits, and evidence having been introduced, and the cause having been submitted to the Court, and the Court having rendered its decision therein,

Now, Therefore, the Court makes the following Findings of Fact and Conclusions of Law: [24]

Findings of Fact

1. Plaintiff, Ajax Hardware Manufacturing Corporation, is a California corporation having a principal place of business in Los Angeles, California, and is the owner by assignment of United States Letters Patent No. Des. 182,602, issued to it by the Patent Office on April 22, 1958.

2. Defendant, Jaybee Manufacturing Corporation, is a California corporation, also having its principal place of business in Los Angeles, California.

3. The patent in suit is for a design for a handle or similar article, and the application was made by Newton S. Leichter, an industrial designer of Los Angeles, California, on July 15, 1957.

4. Since April 22, 1958, defendant has manufactured and sold in this District, and without a license from plaintiff, a pull designated as its No. 567, and exemplified by Exhibit 4.

5. Plaintiff's only witness in support of its case in chief was Norman D. Louis, the president and managing officer of the plaintiff. This witness testified, without the aid of documentary corroboration, that 1959 sales of pulls made in accordance with the patent, and as exemplified by plaintiff's Exhibits 2 or 2-A, amounted to approximately four hundred thousand (400,000) pieces. Yet this was not shown to be unusual for plaintiff's business, nor was it shown that the patented pull obsoleted others. Commercial success was not shown.

6. Norman D. Louis testified that pulls corresponding to Exhibit 2 have been continuously sold by plaintiff from about October of 1957. Exhibit 2 corresponds to the pull illustrated in the patent in suit. Mr. Louis testified that the item was marked with the patent number, as shown by Exhibit 2, some time around May or June of 1958.

7. In support of its allegation that defendant willfully infringed the patent in suit, Mr. Louis testified to a conversation with defendant's sales manager at a Chicago trade show in the latter part of 1958, advising the sales manager that he was "asking for trouble" by bringing out a [25] close copy of plaintiff's pull, reference also having been made to an existing patent or to a pending application. There was no further evidence in support of any allegation of willfulness. The record shows no formal notice of infringement prior to the filing of the present suit. There is no basis for a charge of willfulness, the question of infringement notwithstanding.

8. Defendant, in support of its defense that Newton S. Leichter was not the inventor of the design shown in the patent in suit, read into the evidence a portion of the deposition of Newton S. Leichter, the parties having agreed that the marshal, on behalf of defendant, was unable to serve Mr. Leichter with a subpoena for attendance as a witness at the trial. Defendant also produced Dean Winston Myers of Newport Beach, California, in support of this defense. Trial in the matter was continued until Mr. Leichter could be produced on behalf of plaintiff, and he was produced for plaintiff's rebuttal.

Pursuant to a contract between Newton S. Leichter and Ajax Hardware Manufacturing Corporation (defendant's Exhibit S-1), Leichter hired Myers on an hourly basis to produce sketches for submission to Ajax Hardware Manufacturing Corporation. Myers was instructed by Leichter to produce, in addition to a V-pull (not involved in this controversy), an elongated, bar-type pull of modern design and further characterized by the provision of a "cut-out" or hole so that the background or finish of the cabinet could show through. Without further material supervision, Myers produced, among others, the sketch, Exhibit S-17. While there are certain minor differences between the pull illustrated in the patent and the pull illustrated in Exhibit S-17, the pull illustrated in the patent directly evolved from the sketch, Exhibit S-17.

9. In support of its alternate defense of invalid-

ity, in view of the prior art, defendant relied upon the following items which are prior art:

A. Bassick-Sack pull No. 9453.

B. Bassick-Sack pull No. 9471.

C. Bassick-Sack pull No. 9459. [26]

D. Jaybee pull No. 555.

E-3. Jaybee pull No. 573.

F. Faultless pull No. 941.

F-1. Faultless catalogue of September 15, 1956, and pages 5 and 10 thereof.

F-3. Interiors magazine for December, 1954, and page 116; Whitney Publications, Inc., 18 East 50th Street, New York 22, New York.

G. Faultless pull No. 960.

H. Faultless pull No. 1042.

I. Furniture for Modern Interiors by Mario Del Fabbro, page 98; 8 Reinhold Publishing Corporation, New York City, 1954.

J. Photocopy, plate 23, and typewritten copy of the description thereof, from the book Polynesian Artifacts, 2nd Edition, published in Wellington, N. Z., by the Polynesian Society, Inc., 1953.

K. Catalogue sheet, the Widdicomb Furniture Company of Grand Rapids, Michigan, No. 2016 Hikie.

M-1. A model of pull of Clayton patent, Exhibit 5.

M-2. A model of pull of Heyer patent, Exhibit 6.

Exhibit H, among others, is closer to the patented design than Exhibits M-1 or M-2, which are models of the pulls shown in the only prior art patents, Exhibits 5 and 6, found by the Examiner. Exhibits

A, B and C show pulls characterized by the provision of one or more holes, and one of them is similar to that of the pull of the patent in suit. The design illustrated in the patent is, nevertheless, with respect to prior art items relied upon by defendant, new, original and ornamental.

10. In support of its defense of non-infringement, defendant produced two witnesses, both persons who, in the normal course of business, purchase door pulls. One witness, Louis Weintraub, is the owner [27] of a hardware business in Los Angeles, California; and the other, Max Bertisch, is a building contractor. The testimony of these witnesses corroborates the conclusions that an ordinary observer, giving such attention as a purchaser usually gives, could not be deceived into purchasing the accused pull, Exhibit 4, believing it to be the pull shown in the patent in suit; that Exhibit 4 can be readily distinguished from the pull shown in the patent; that Exhibit 4 and the pull shown in the patent in suit do not look alike.

11. The accused pull, Exhibit 4, does not infringe United States Letters Patent No. Des. 182,602 or the claim thereof.

12. Plaintiff has admitted that it has issued notices, at least in two instances, to the trade and to customers of defendant to the effect that plaintiff intends to prosecute customers of defendant under Design Patent No. 182,602 because of resale by said customers of goods manufactured by defendant, such notices being Exhibits N-1 and N-2.

On the basis of the foregoing, the Court makes the following

Conclusions of Law

1. This Court has jurisdiction of the parties and of the subject matter.

2. Newton S. Leichter is the sole inventor of the subject matter of United States Letters Patent No. Des. 182,602.

3. United States Letters Patent No. Des. 182,602 is valid.

4. Plaintiff has complied with the requirements of marking, as prescribed in §287 of Title 35 of the United States Code.

5. The Jaybee pull No. 567 and exemplified by Exhibit 4, manufactured and sold by the defendant, does not infringe said United States Letters Patent No. Des. 182,602 or the claim thereof.

6. The prior art relied upon by defendant does not support defendant's contention of invalidity, particularly in the light of the presumption of validity of §282 of Title 35 of the United States Code. [28]

7. The evidence produced by the defendant in support of its defense that the said Newton S. Leichter was not the sole inventor of the subject matter of the patent in suit is inadequate as a matter of law, and particularly in view of the presumption of validity of §282 of Title 35 of the United States Code.

8. Plaintiff is entitled to take nothing by its complaint.

9. Plaintiff having issued threats of suit to defendant's customers, defendant is entitled to an

injunction enjoining and restraining plaintiff, its officers, agents, servants, employees and attorneys and those in active concert or participating with it from asserting, contending, claiming or alleging that said Design Patent No. 182,602 is or ever was infringed by defendant, Jaybee Manufacturing Corporation, or its customers on account of the manufacture and sale by said defendant or the resale by its customers of the accused articles.

10. Defendant is entitled to costs of suit.

11. Defendant is entitled to a declaration of rights between the parties.

Judgment

In accordance with the foregoing Findings of Fact and Conclusions of Law, it is Ordered, Adjudged and Decreed:

1. That United States Letters Patent No. Des. 182,602, issued on April 22, 1958, to the plaintiff, Ajax Hardware Manufacturing Corporation, assignee of Newton S. Leichter, for a term of fourteen years for a design for a handle or similar article, is valid, and said Newton S. Leichter is the original, first and sole inventor of said design.

2. That the drawer pull manufactured and sold by the defendant, Jaybee Manufacturing Corporation, and designated by it as its No. 567, does not infringe said United States Letters Patent No. Des. 182,602.

3. That the complaint is dismissed with prejudice.

4. That a final injunction shall be issued enjoining and [29] restraining Ajax Hardware Manufac-

turing Corporation, its officers, agents, servants, employees and attorneys and those in active concert or participating with it, from asserting, contending, claiming or alleging that United States Letters Patent No. Des. 182,602 is or ever was infringed by Jaybee Manufacturing Corporation or its customers on account of the manufacture or sale by said Jaybee Manufacturing Corporation or the resale by its customers of articles identified as Jaybee Pull No. 567.

5. That defendant shall have and recover from plaintiff its costs in this action in the sum of $..... to be taxed by the Clerk.

Dated at Los Angeles, California, this .... day of January, 1960.

.....
United States District Judge.

Approved as to form:

FLAM AND FLAM,
By FREDERICK FLAM,
Attorneys for Defendant.
HUEBNER & WORREL,
HERBERT A. HUEBNER,
GEORGE H. HALBERT,
HARLAN P. HUEBNER,
By .....
Attorneys for Plaintiff.

Proof of Service by Mail Attached. [34]

[Endorsed]: Filed January 22, 1960.

San Diego
California
February 12, 1960

Huebner & Worrel
Herbert A. Huebner, Esq.
George H. Halbert, Esq.
Harlan P. Huebner, Esq.
610 South Broadway
Los Angeles, 14, California

Flam and Flam
Frederick Flam, Esq.
2978 Wilshire Boulevard
Los Angeles 5, California

Re: Civil No. 316-59-K. Ajax Hardware Mfg. Co. vs. Jaybee Manufacturing Co.

Gentlemen:

After having considered the findings of fact submitted in the above-entitled matter by each of the parties and objections thereto, I have rewritten the findings of fact, conclusions of law and judgment, copy of which is enclosed.

Sincerely,

FRED KUNZEL,
U. S. District Judge.

Enc. [35]

In the United States District Court, Southern District of California, Central Division

Civil Action No. 316-59-K

AJAX HARDWARE MANUFACTURING CORPORATION, Plaintiff,

vs.

JAYBEE MANUFACTURING CORPORATION, Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This cause having duly come on for trial and evidence both oral and documentary having been introduced the Court now makes the following findings of fact, conclusions of law and judgment.

Findings of Fact

1. Plaintiff is a California corporation having its principal place of business in the Southern District of California, Central Division.

2. On April 22, 1958, United States Letters Patent Des. No. 182,602 was duly issued to plaintiff for a term of fourteen years for a design for a handle or similar article, by virtue of an assignment from the applicant, Newton S. Leichter.

3. Since said date plaintiff has been and still is the owner of said United States Letters Patent Des. No. 182,602. [36]

4. Plaintiff, in accordance with the teachings of said United States Letters Patent Des. No. 182,602, has manufactured and sold a handle or similar article which it designates as its Number 547 Drawer Pull, and has achieved commercial success therein.

5. Defendant is a California corporation having its principal place of business in the Southern District of California, Central Division.

6. Since the issuance to plaintiff of said United States Letters Patent Des. No. 182,602, within six years last past, and within the term of said Letters Patent, defendant has manufactured and sold in the Southern District of California and elsewhere, without license of plaintiff, a handle or similar article which it designates as its Number 567 Drawer Pull.

7. That the said drawer pull manufactured and sold by the defendant Jaybee Manufacturing Corporation designated by its No. 567 does not infringe said United States Letters Patent Des. No. 182,602.

8. That the allegations of defendant's counterclaim are not true with the exception that plaintiff issued certain notices to customers of the defendant that its Drawer Pull No. 567 infringed the patent owned by plaintiff designated as United States Letters Patent Des. No. 182,602.

From the foregoing findings of fact the Court makes the following:

Conclusions of Law

1. This Court has jurisdiction hereof by virtue of the provisions of Title 35 of the United States

Code, as amended, and Title 28, Sections 1338, 2201 and 2202, and [37] this Court has jurisdiction of both parties hereto.

2. United States Letters Patent Des. No. 182,602 is valid.

3. The drawer pull No. 567 manufactured and sold by the defendant does not infringe said United States Letters Patent Des. No. 182,602. or the claim thereof.

4. That defendant is entitled to no relief under the allegations of its counterclaim.

In accordance with the foregoing findings of fact and conclusions of law the Court makes the following:

Judgment

It Is Ordered, Adjudged and Decreed:

1. That plaintiff take nothing by reason of its complaint.

2. That defendant take nothing by reason of its counterclaim.

3. That defendant have and recover its cost of suit in the amount of $297.13.

Dated: At San Diego, California, this 12th day of February, 1960.

/s/ FRED KUNZEL,
United States District Judge.

[Endorsed]: Filed February 12, 1960. Entered February 16, 1960.

United States District Court, Southern District of California

Office of the Clerk

Room 231, U. S. Post Office & Court House
Los Angeles-12, California

George H. Halbert, Esq.
610 South Broadway
Los Angeles 14, Calif.

Flam & Flam, Esq.
2978 Wilshire Blvd.
Los Angeles 5, Calif.

Re: Ajax Hardware Mfg. Co. vs. Jaybee Mfg. Corp., No. 316-59-K.

You are hereby notified that judgment in the above-entitled case was entered this day Feb. 16, 1960 in the docket.

I hereby certify that this notice was mailed on Feb. 16, 1960.

CLERK, U. S. DISTRICT COURT,
/s/ By C. A. SIMMONS,
Deputy Clerk. [39]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO COURT OF APPEALS

Notice is hereby given that Jaybee Manufacturing Corporation, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from that portion of the Judgment entered February 16, 1960, as follows: "It Is Ordered, Adjudged and Decreed: * * * 2. That defendant take nothing by reason of its counterclaim.", and from that portion of the Findings of Fact, Conclusions of Law and Judgment entered February 16, 1960, which find, conclude or adjudge that United States Letters Patent No. Des. 182,602 is valid.

Dated this 17th day of March, 1960.

FLAM AND FLAM,
/s/ By FREDERICK FLAM,
Attorneys for Appellant, Jaybee Manufacturing Corporation. [40]

[Endorsed]: Filed March 17, 1960.

[Title of District Court and Cause.]

STATEMENT ON POINTS ON APPEAL UNDER RULE 75(d)

The points on which defendant-appellant, Jaybee Manufacturing Corporation, intends to rely on this appeal are as follows:

1. The District Court, hereinafter referred to as the "Court", erred in finding that United States Letters Patent No. Des. 182,602 was duly issued to plaintiff, as set forth in Finding of Fact No. 2.

2. Except for the exception therein noted, the Court erred in finding that the allegations of defendant's Counterclaim are not true, and as set forth in Finding of Fact No. 8.

3. The Court erred in concluding that United States Letters Patent No. Des. 182,602 is valid and as set forth in Conclusion of Law No. 2.

4. The Court erred in concluding that defendant is entitled to no relief under the allegations of its Counterclaim, and as set forth in Conclusion of Law No. 4. [46]

5. The Court erred in holding that the defendant take nothing by reason of its Counterclaim, and as set forth in Item 2 of the Court's Judgment.

March 28, 1960.

FLAM AND FLAM,
/s/ By FREDERICK FLAM,
Attorneys for Defendant-Appellant, Jaybee Manufacturing Corporation. [47]

Proof of Service by Mail Attached. [48]

[Endorsed]: Filed March 29, 1960.

[Title of District Court and Cause.]

CERTIFICATE BY THE CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the foregoing documents together with the other items, all of which are listed below, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case; and that said items are the originals unless otherwise shown on this list:

Page:

1. Names and Addresses of Attorneys.
2. Complaint, filed 4/7/59.
8. Answer and Counterclaim, filed 5/18/59.
16. Answer to Counterclaim, filed 6/4/59.
20. (Copy) Memorandum to Counsel from Judge Fred Kunzel, dated 1/13/60.
21. Defendant's Objections to proposed Findings of Fact, Conclusions of Law and Judgment, filed 1/22/60.
35. (Copy) Letter dated 2/12/60 from Fred Kunzel, U. S. District Judge.
36. Findings of Fact, Conclusions of Law and Judgment, filed 2/12/60 and entered 2/16/60.
39. (Copy) Clerk's notice of entry of judgment, dated 2/16/60.
40. Notice of Appeal, filed 3/17/60.
41. Designation of contents of record on appeal, filed 3/29/60.
46. Statement on Points on appeal, filed 3/29/60.

Two volumes of Reporter's Transcript of Proceedings had on: December 15 and 16, 1959; January 11, 1960.

Plaintiff's Exhibits 1, 5 and 6.

Defendant's Exhibits A, A-1, B, C, D, E-3, F, F-1, F-2, G, H, I, K, M, M-1, M-2, N-1, N-2, P-1, P-2, P-3, P-4 and T.

Dated: April 12, 1960.

[Seal] JOHN A. CHILDRESS,
Clerk.
/s/ By WM. A. WHITE,
Deputy Clerk.

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, California
Tuesday, December 15, 1959

Honorable Fred Kunzel, Judge Presiding. [1]*

Appearances: For the Plaintiff and Cross-Defendant: Huebner & Worrell, By: George N. Halbert, Esq., 610 South Broadway, Los Angeles 14, California. For the Defendant and Cross-Plaintiff: Flam & Flam, By: Frederick Flam, Esq., and John Flam, Esq., 2978 Wilshire Boulevard, Los Angeles 5, California. [2]

* * * * *

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* Page numbers appearing at top of page of Reporter's Transcript of Record.

Mr. Halbert: * * * I offer in evidence a copy of the patent in suit, which is design patent No. 182,602, issued April 22, 1958, in the name of Newton S. Leichter, assignor to Ajax Hardware Manufacturing Corporation, the plaintiff in this case.

The Court: It may be received and marked——

The Clerk: Plaintiff's Exhibit 1, your Honor.

(The document referred to was marked Plaintiff's Exhibit 1, and received in evidence. [6]

* * * * *

Mr. Halbert: I offer in evidence a copy of design patent No. 169,257 to Heyer, which has been lodged as Plaintiff's Exhibit No. 5, and is one of the references cited in Plaintiff's Exhibit No. 1.

The Court: It may be received.

The Clerk: Plaintiff's 5 admitted.

(The exhibit heretofore marked Plaintiff's Exhibit 5 was received in evidence.)

Mr. Halbert: I offer in evidence a copy of design patent No. 180,684 to Clayton, which was lodged as Plaintiff's Exhibit No. 6, and which is the other reference cited in Plaintiff's Exhibit No. 1.

The Court: It may be received.

The Clerk: Plaintiff's Exhibit 6 admitted.

(The exhibit heretofore marked Plaintiff's Exhibit 6 was received in evidence.) [35]

* * * * *

NORMAN D. LOUIS

called as a witness on behalf of the plaintiff, having been first duly sworn, was examined and testified as follows: [26]

* * * * *

Cross Examination * * * * *

Mr. Frederick Flam: I would like to refer the witness to Exhibits A and B appended to Notice of Motion for Preliminary Injunction, filed May 29, 1959.

(The documents were placed before the witness.)

The Witness: Yes.

Q. (By Mr. Frederick Flam): Now, did you write those letters? A. Yes, I did.

Q. All right. Then you know how to write a letter of infringement, do you not?

A. Well, thanks for the compliment. All I wrote and told them was that I wanted them to know they were buying the Jaybee pull instead of our pull, when we came out with it, and, therefore, I wanted them to know that we were going to file suit, or we did file suit. I haven't read the letter actually over.

Q. Did you get any help in composing this letter? [54]

A. No, I did not. I may have talked it over with George, with Mr. Halbert, but I don't know that I actually worded it. I just wrote a letter.

Q. I would like to ask you this further: Are you a member of the Bar of this State?

(Testimony of Norman D. Louis.)

A. Yes.

Mr. Frederick Flam: All right. I would like to offer in evidence the letters, Exhibits A and B, which are appended to this document, as Exhibits N-1 and N-2.

Mr. Halbert: May I ask whether they have been lodged?

Mr. Frederick Flam: They have been identified, I believe, in the pretrial order. They were a part of the original records.

The Court: Yes, they were.

Mr. Halbert: Without objection——

The Court: They were referred to, I believe, in the pretrial order.

Mr. Halbert: Without objection, if they were.

The Court: They may be received.

The Clerk: N-1 and N-2 admitted.

(The documents referred to were marked Defendant's Exhibits N-1 and N-2, and received in evidence.) [55]

* * * * *

Mr. Frederick Flam: At this time, your Honor, I would like to offer in evidence requests for admissions, and answers. There are two sets, comprising four documents, respectively, a document filed July 27, 1959, which comprises within it Request for Admissions; a document filed August 28, 1959, comprising Responses to Request for Admissions; a document filed September 21, 1959, entitled Request for Supplemental Admissions, and a document, dated September 28, 1959, entitled Plain-

tiff's Response to Second Supplemental Request for Admissions as Defendant's Exhibits P-1, P-2, P-3 and P-4.

The Court: They may be received.

(The documents referred to were marked Defendant's Exhibits P-1, P-2, P-3 and P-4, and received in evidence.) [56]

* * * * *

Mr. Frederick Flam: All right. Now, I would like to offer Exhibits A, B, C, F, G and H, the pulls identified.

Mr. Halbert: No objection.

The Court: They may be received.

The Clerk: Exhibits A, B, C, F, G and H admitted.

(The exhibits heretofore marked Defendant's Exhibits A, B, C, F, G and H, were received in evidence.) [62]

* * * * *

Mr. Frederick Flam: I wish to offer that in evidence, and draw particular attention to page 98, in the lower left-hand corner.

Mr. Halbert: What page?

Mr. Frederick Flam: 98.

Mr. Halbert: Thank you.

Mr. Frederick Flam: As Exhibit I.

The Court: It may be received.

The Clerk: Exhibit I admitted.

(The exhibit referred to was marked Defendant's Exhibit I and received in evidence.)

* * * * *

Mr. Frederick Flam: I offer that as Exhibit K.

The Court: All right. It may be received.

* * * * *

The Clerk: Defendant's Exhibit K admitted.

(The exhibit referred to was marked Defendant's Exhibit K, and received in evidence.) [64]

* * * * *

Mr. Halbert: No objection.

The Court: It may be received.

The Clerk: Exhibit F-1 admitted.

(The exhibit marked Defendant's Exhibit F-1 was received in evidence.) [65]

* * * * *

Mr. Frederick Flam: At this time I would like to offer in evidence as Exhibit A-1 a looseleaf with removable pages entitled "Bassick-Sack Modern Catalog." That is as Exhibit A-1.

Mr. Halbert: May I see it, please?

(The document was handed to counsel.)

Mr. Halbert: No objection.

The Court: It may be received. [66]

The Clerk: Defendant's Exhibit A-1 admitted.

(The exhibit referred to was marked Defendant's Exhibit A-1 and received in evidence.)

Mr. Frederick Flam: I would like to offer at this time as Exhibit F-2 a catalog of Faultless Furniture Hardware.

Mr. Halbert: No objection.

The Court: It may be received.

The Clerk: Defendant's Exhibit F-2 admitted.

(The exhibit referred to was marked Defendant's Exhibit F-2 and received in evidence.)

Mr. Frederick Flam: At this time I would like to offer in evidence a certified file history of this application for patent as Exhibit M.

Mr. Halbert: No objection.

The Court: It may be received.

The Clerk: Exhibit M admitted.

(The exhibit referred to was marked Defendant's Exhibit M, and received in evidence.) [67]

* * * * *

JAKE BORENSTEIN

called as a witness on behalf of the defendant, having been first duly sworn, was examined and testified as follows:

* * * * *

Direct Examination

Q. (By Mr. Frederick Flam): What is your occupation?

A. I am president of the Jaybee Manufacturing Corporation.

Q. The defendant in this case? A. Yes.

Q. Are you active in the management of that corporation? A. Yes.

Q. I will hand you Exhibit D-1 and E-1, for identification. Can you identify these exhibits?

A. These are price lists that we have put out. D-1 was published November 23, 1956, and E-1 was published April 15, 1958.

Q. Do either of these catalogs show the No. 555 pull corresponding with Exhibit E? [77]

A. Catalog E-1 shows the 555 pull on page 17.

(Testimony of Jake Borenstein.)

Mr. Halbert: Your Honor, if we are getting down to whether this 555 pull and the other one that the other witness was talking about were made and sold before ours, we will admit it, and it will save an awful lot of time.

Mr. Frederick Flam: Very well. It was denied vehemently.

The Court: The 555 pull is exhibit what?

Mr. Frederick Flam: Exhibit D.

Mr. Halbert: D.

The Court: D, all right. Let's proceed.

The Clerk: Is there a ruling on D, your Honor?

The Court: It may be received.

The Clerk: Exhibit D admitted.

(The exhibit heretofore marked Defendant's Exhibit D was received in evidence.) [78]

* * * * *

Mr. Frederick Flam: At this time, your Honor, I would like to offer in evidence as examples of the two patented pulls found by the Examiner two exhibits which are appended to this board.

I would like, first of all, to offer in evidence as [100] a sample of the Clayton patent the black pull on the left as Exhibit M-1.

The Court: That may be received.

* * * * *

The Clerk: M-1 admitted.

(The exhibit referred to was marked Defendant's Exhibit M-1 and received in evidence.)

* * * * *

Mr. Frederick Flam: * * * * * I will offer one of the pulls as Exhibit M-2.

* * * * *

The Court: That may be received.

The Clerk: M-2 admitted.

(The exhibit referred to was marked Defendant's Exhibit M-2 and received in evidence.)

Mr. Frederick Flam: I would like to offer at this time as Exhibit T pull No. 1319 made by Faultless Furniture Hardware.

Mr. Halbert: Could I have just a second, your Honor?

(Counsel examines the pull referred to.)

Mr. Halbert: I have no objection.

The Court: It may be received.

The Clerk: T admitted.

(The exhibit referred to was marked Defendant's Exhibit T and received in evidence.) [102]

* * * * *

Mr. Frederick Flam: Also, to clarify the record, in the event there is any doubt about it, I would like to offer at this time, if I have not already, Exhibit E-3 in evidence.

The Court: E-what?

Mr. Frederick Flam: E-3.

Mr. Halbert: No objection.

The Court: It may be received.

(The exhibit heretofore marked Defendant's Exhibit E-3 was received in evidence.) [184]

* * * * *

[Endorsed]: Filed February 2, 1960.

United States Patent Office

Des. 182,602
Patented Apr. 22, 1958

182,602

HANDLE OR SIMILAR ARTICLE

Newton S. Leichter, Los Angeles, Calif., assignor to Ajax Hardware Manufacturing Corp., Los Angeles, Calif., a corporation of California

Application July 15, 1957, Serial No. 46,945

Term of patent 14 years

(Cl. D10—8)

FIG. 1.

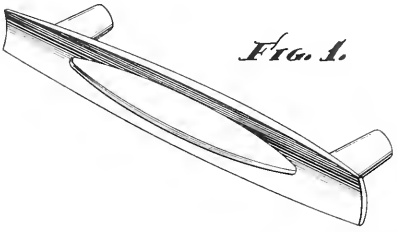

FIG. 2.

FIG. 3.

FIG. 4.

FIG. 5.

Figure 1 is a perspective view of the face of a handle showing my new design.

Figure 2 is a face view of the same.

Figure 3 is a top plan view of the handle.

Figure 4 is a rear elevational view of the handle.

Figure 5 is an end elevation of the handle taken from the right of Figure 2.

I claim:

The ornamental design for a handle or similar article, as shown.

References Cited in the file of this patent

UNITED STATES PATENTS

D. 169,257	Heyer	Apr. 7, 1953
D. 180,684	Clayton	July 23, 1957

Patented Apr. 7, 1953

Des. 169,257

UNITED STATES PATENT OFFICE

169,257

PULL FOR DRAWERS, CABINET DOORS, AND THE LIKE

Don Heyer, El Monte, Calif.

Application October 10, 1952, Serial No. 21,775

Term of patent 7 years

(Cl. D10—8)

To all whom it may concern:

Be it known that I, Don Heyer, a citizen of the United States and a resident of El Monte, county of Los Angeles, California, have invented a new, original, and ornamental Design for a Pull for Drawers, Cabinet Doors, and the like, of which the following is a specification, reference being had to the accompanying drawing, forming part thereof.

Referring to the drawing:

Fig. 1 is a perspective view of a pull for drawers, cabinet doors, and the like, showing my new design;

Fig. 2 is a perspective view thereof, as seen from the side opposite that shown in Fig. 1;

Fig. 3 is an elevational view looking in the direction of the arrow 3 in Fig. 1;

Fig. 4 is an elevational view looking in the direction of the arrow 4 in Fig. 1; and

Fig. 5 is an elevational view looking in the direction of the arrow 5 in Fig. 1.

I claim:

The ornamental design for a pull for drawers, cabinet doors, and the like, as shown.

DON HEYER.

References Cited in the file of this patent

UNITED STATES PATENTS

Number	Name	Date
D. 130,353	Janes	Nov. 11, 1941
D. 152,198	Hay	Dec. 28, 1948

April 7, 1953 D. HEYER Des. 169,257

PULL FOR DRAWERS, CABINET DOORS, AND THE LIKE

Filed Oct. 10, 1952

Fig. 1.

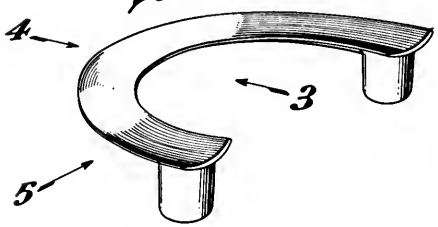

Fig. 2.

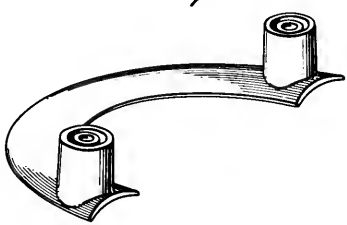

Fig. 3.

Fig. 4.

Fig. 5.

DON HEYER,
INVENTOR.

BY
Paul A. Weilein
ATTORNEY.

United States Patent Office

Des. 180,684
Patented July 23, 1957

180,684

PULL

La Verne E. Clayton, Rockford, Ill., assignor to Amerock Corporation, a corporation of Illinois

Application October 27, 1955, Serial No. 38,595

Term of patent 14 years

(Cl. D10—8)

Fig. 1

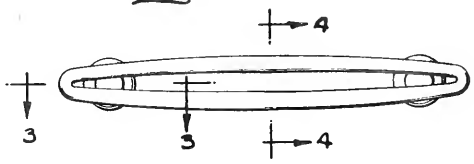

Fig. 2

Fig. 3

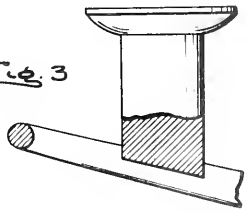

Fig. 4

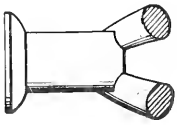

Figure 1 is a front elevation of a pull showing my new design.

Fig. 2 is a plan view.

Fig. 3 is an enlarged sectional view taken along the line 3—3 in Fig. 1.

Fig. 4 is an enlarged sectional view taken along the line 4—4 in Fig. 1.

I claim:

The ornamental design for a pull, substantially as shown.

References Cited in the file of this patent

UNITED STATES PATENTS

D. 98,439	Martin	Feb. 4, 1936
D. 169,302	Borchers	Apr. 14, 1953

DEFENDANT'S EXHIBIT "N-1"

[Letterhead of Ajax Hardware Manufacturing Corp., Los Angeles 32, California]

Registered—Return Receipt Requested

April 16, 1959

Crest Hardware Company
9330 W. Pico
Los Angeles, California

Gentlemen:

It has come to our attention that you are selling a product, manufactured by Jaybee Manufacturing Company which is in violation of our Patent #182,602.

This is a design for a Pull that we have originated. We have filed suit in the Federal Courts against Jaybee Manufacturing Company for infringement of our Patent. If you continue to offer for sale and sell this Pull made by Jaybee Manufacturing Company which has been copied after our #547 Pull, you will leave us no alternative but to also include you as a violator of our Patent in our course of protection of our rights in the Federal Courts.

For your identification, it is our understanding that the Pull which Jaybee Manufacturing Com-

Defendant's Exhibit "N-1"—(Continued)

pany manufactures which is similar to our #547 Pull is their #567.

Very truly yours,

AJAX HARDWARE
MANUFACTURING CORP.
/s/ NORMAN LOUIS
Norman D. Louis

NDL:bcf

Admitted in Evidence December 15, 1959.

DEFENDANT'S EXHIBIT "N-2"

[Letterhead of Ajax Hardware Manufacturing Corp., Los Angeles 32, California]

Registered—Return Receipt Requested

April 16, 1959

Los Angeles Hardware Company
8361 W. 3rd Street
Los Angeles 48, California

Gentlemen:

It has come to our attention that you are selling a product, manufactured by Jaybee Manufacturing Company which is in violation of our Patent #182,602.

This is a design for a Pull that we have originated. We have filed suit in the Federal Courts

Defendant's Exhibit "N-2"—(Continued)

against Jaybee Manufacturing Company for infringement of our Patent. If you continue to offer for sale and sell this Pull made by Jaybee Manufacturing Company which has been copied from our #547 Pull, you will leave us no alternative but to also include you as a violator of our Patent in our course of protection of our rights in the Federal Courts.

For your identification, it is our understanding that the Pull which Jaybee Manufacturing Company manufactures which is similar to our #547 Pull is their #567.

Very truly yours,

AJAX HARDWARE
MANUFACTURING CORP.
NORMAN D. LOUIS

NDL:bcf

Admitted in Evidence December 15, 1959.

DEFENDANT'S EXHIBIT "P-2"

[Title of District Court and Cause.]

RESPONSE TO REQUEST FOR ADMISSIONS AND SUPPLEMENTAL ADMISSIONS

Ajax Hardware Manufacturing Corporation, the plaintiff herein (hereinafter sometimes referred to as "Ajax"), makes the following statements in response to the request for admissions and request

Defendant's Exhibit "P-2"—(Continued)

for supplemental admissions heretofore served upon it by the defendant.

Request No. 1: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No. R-960 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by said Faultless Furniture Hardware as No. R-960 was put into production in the Fall of 1952, and was first shown in the Faultless Furniture Hardware catalog in January 1955.

Request No. 2: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull identified as R-960 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, was on sale in this country.

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by said Faultless Furniture Hardware as No. R-960 was put into production in the Fall of 1952, and was first shown in the Faultless Furniture Hardware catalog in January, 1955.

Request No. 3: Before the alleged invention of the subject matter of Design Patent No. D-182,602,

Defendant's Exhibit "P-2"—(Continued)

by Newton S. Leichter, a pull, identified by No. R-1042 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge as to a pull identified by No. R-1042 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, and when, if at all, such a pull was publicly known and publicly used in this country, although plaintiff has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by said Faultless Furniture Hardware as No. R-1042 was put into production in the Fall of 1952, and was first shown in the Faultless Furniture Hardware catalog in January, 1955.

Request No. 4: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull identified as R-1042 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana was on sale in this country.

Answer: Plaintiff has no knowledge as to a pull identified by No. R-1042 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, and when, if at all, such a pull was on sale in this country, although plaintiff has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by said Faultless Furniture Hardware as No. R-1042 was put into production in the Fall of 1952, and was first shown in the Faultless Furniture Hardware catalog in January, 1955.

Defendant's Exhibit "P-2"—(Continued)

Request No. 5: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No. R-941 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull No. R-941 was designed in 1952; that drawings thereof were made and dated August 14, 1952; and that such a pull was first shown in the catalog of said company, dated January, 1955.

Request No. 6: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull identified as R-941 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana, was on sale in this country.

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture that a pull No. R-941 was designed in 1952; that drawings thereof were made and dated August 14, 1952; and that such a pull was first shown in the catalog of said company, dated January, 1955.

Request No. 7: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No. R-1319 by its manufacturer, Faultless Furniture

Defendant's Exhibit "P-2"—(Continued)

Hardware of Evansville, Indiana was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a Pull No. R-1319 was first shown in a catalog of Faultless Furniture Hardware released in January, 1959, and on the basis of said information plaintiff denies that said Pull No. R-1319 was publicly known and publicly used in this country before the invention of the subject matter of the patent in suit.

Request No. 8: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull identified as R-1319 by its manufacturer, Faultless Furniture Hardware of Evansville, Indiana was on sale in this country.

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by said Faultless Furniture Hardware as R-1319 was first shown in a catalog of Faultless Furniture Hardware released in January, 1959, and on the basis of said information plaintiff denies that said Pull No. R-1319 was on sale in this country more than one year prior to the date of the application for patent in suit.

Request No. 13: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No.

Defendant's Exhibit "P-2"—(Continued)

DC-9453 by its manufacturer, Bassick-Sack of Winston-Salem, North Carolina, was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack of Winston-Salem, North Carolina, that a pull identified by No. DC-9453 was originally designed in 1952, and sold in 1953.

Request No. 14: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull, identified as No. DC-9453 by its manufacturer, Bassick-Sack of Winston-Salem, North Carolina, was on sale in this country.

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack of Winston-Salem, North Carolina, that a pull identified by No. DC-9453 was originally designed in 1952, and sold in 1953.

Request No. 15: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No. DC-9471 by its manufacturer, Bassick-Sack of Winston-Salem, North Carolina, was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-

Defendant's Exhibit "P-2"—(Continued)

Sack that a pull identified by No. DC-9471 was originally designed in 1952 and sold in 1953.

Request No. 16: More than one year prior to the date of the application for Design Patent No. D-182,602, a pull, identified as No. DC-9471 by its manufacturer, Bassick - Sack of Winston - Salem, North Carolina, was on sale in this country.

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack of Winston-Salem, North Carolina, that a pull identified by No. DC-9471 was originally designed in 1952, and sold in 1953.

Request No. 17: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull, identified by No. DC-9459 by its manufacturer, Bassick-Sack of Winston-Salem, North Carolina was publicly known and publicly used in this country.

Answer: Plaintiff has no knowledge when said pull was publicly known and publicly used in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack that a pull identified by No. DC-9459 was originally designed in 1952, and sold in 1953.

Request No. 18: More than one year prior to the date of the application for said Design Patent No. D-182,602, a pull, identified as No. DC-9459 by its manufacturer, Bassick - Sack of Winston - Salem, North Carolina was on sale in this country.

Defendant's Exhibit "P-2"—(Continued)

Answer: Plaintiff has no knowledge when said pull was on sale in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack of Winston-Salem, North Carolina, that a pull identified by No. DC-9459 was originally designed in 1952, and sold in 1953.

Request No. 22: A book entitled "Polynesian Artifacts" (Second Edition), the Oldmen Collection, published in Wellington, New Zealand, by the Polynesian Society Inc., in 1953, was received by the Los Angeles Librarian in Los Angeles, California, more than one year prior to the date of the application for patents in the United States by the said Newton S. Leichter.

Answer: Plaintiff denies that said book was received by the Los Angeles Librarian more than one year prior to the date of the application for the patent on which this suit is based.

Request No. 24: Before the alleged invention by Newton S. Leichter of the pull of Patent No. D-182,602, the Witticomb Furniture Company of Grand Rapids, Michigan produced for public use and sale a furniture item identified as No. 2016 Hikie, in this country.

Answer: Plaintiff has no knowledge when said furniture item was first produced for public use and sale, but has used due diligence to obtain such knowledge, and has been advised by said Witticomb Furniture Company of Grand Rapids, Michigan, that a furniture item identified as No. 2016 Hikie,

Defendant's Exhibit "P-2"—(Continued)

was produced by them during the latter part of 1953, and publicly offered for sale in January, 1954.

Request No. 25: More than one year prior to the application for patent in the United States by the said Newton S. Leichter, the Witticomb Furniture Company sold benches identified as No. 2016 Hickie, in the United States.

Answer: Plaintiff has no knowledge when said furniture item was first produced for public use and sale, but has used due diligence to obtain such knowledge, and has been advised by said Witticomb Furniture Company that a furniture item identified as No. 2016 Hickie, was produced by them during the latter part of 1953, and publicly offered for sale in January, 1954.

Request No. 27: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull identified as No. 555 by Jaybee Manufacturing Corporation, was publicly known and publicly used in this country.

Answer: Plaintiff is unable to admit or deny this request, because the matter is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 28: More than one year prior to the date of application for said Design Patent No. D-182,602, a pull identified as No. 555 by Jaybee Manufacturing Corporation was on sale in this country.

Answer: Plaintiff is unable to admit or deny this request, because the matter is particularly

Defendant's Exhibit "P-2"—(Continued)

within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 29: A sample of said item No. 555 referred to in Request for Admissions 27 and 28 is located at the office of Flam and Flam, 2978 Wilshire Boulevard, and which will be deposited as defendant's Exhibit D, and which is now available for inspection during business hours at the offices of Flam and Flam on any reasonable advance notice, corresponds to said item No. 555 referred to in Requests for Admissions 27 and 28, as publicly known, publicly used, and on sale as stated in said Requests.

Answer: Plaintiff is unable to admit or deny this request, because the matter is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 30: Before the alleged invention of the subject matter of Design Patent No. D-182,602, by Newton S. Leichter, a pull identified as No. 573 by Jaybee Manufacturing Corporation, was publicly known and publicly used in this country.

Answer: Plaintiff is unable to admit or deny this request, because the matter is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 31: The sample of said item No. 573, referred to in Requests for Admissions 30, located at the office of Flam and Flam, 2978 Wilshire Boulevard, and which will be deposited as defendant's Exhibit E, and which is now available for inspection during business hours at the offices

Defendant's Exhibit "P-2"—(Continued)

of Flam and Flam on any reasonable advance notice, corresponds to the item referred to in Requests for Admissions 30, as publicly known, publicly used, and on sale as stated in said Requests.

Answer: Plaintiff is unable to admit or deny this request, because the matter is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

AJAX HARDWARE MANUFACTURING CORPORATION,
/s/ By NORMAN D. LOUIS,
President.

State of California
County of Los Angeles—ss.

Personally appeared before me, Norman D. Louis, President of Ajax Hardware Manufacturing Corporation, the plaintiff herein, and says that he has read the foregoing Response to Request for Admissions and Supplemental Admissions, and knows the contents thereof; and that the same are true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters he believes it to be true.

Dated: August 25, 1959.

[Seal] /s/ HAZEL Z. SHANNON,
Notary Public in and for Said County and State.
My Commission Expires January 15, 1961.

Admitted in Evidence December 15, 1959.

[Endorsed]: Filed August 28, 1960.

DEFENDANT'S EXHIBIT "P-3"

[Title of District and Cause.]

DEFENDANT'S AND CROSS-PLAINTIFF'S REQUEST FOR SUPPLEMENTAL ADMISSIONS

Pursuant to the provisions of Rule 36 of the Federal Rules of Civil Procedure, and subject to reimbursement for reasonable expenses and attorney's fees, as provided in Rule 37c of the Rules of Civil Procedure, defendant and cross-plaintiff, Jaybee Manufacturing Corporation requests the following supplemental admissions of plaintiff and cross-defendant Ajax Hardware Manufacturing Corporation to be answered within ten (10) days separately and fully under oath, by Norman D. Louis, President of said Ajax Hardware Manufacturing Corporation:

32. Defendant's Exhibit A, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

33. Defendant's Exhibit B, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

34. Defendant's Exhibit C, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter

Defendant's Exhibit "P-3"—(Continued)

of Design Patent No. Des. 182,602 by Newton S. Leichter.

* * * * *

37. Defendant's Exhibit F, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

38. Defendant's Exhibit G, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

39. Defendant's Exhibit H, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

* * * * *

64. Defendant's Exhibit I, lodged herein, is a printed publication entitled "Furniture for Modern Interiors" and published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

65. Defendant's Exhibit K, lodged herein, is a printed publication of the Widdicomb Furniture Company of Grand Rapids, Michigan and published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602.

Defendant's Exhibit "P-3"—(Continued)

66. Defendant's Exhibit F-1, lodged herein, is a printed publication of Faultless Caster Corporation, published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

67. Defendant's Exhibit F-3, lodged herein, is a printed publication, "Interiors" and published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

68. Defendant's Exhibit J, lodged herein, is an accurate reproduction, part photostatic and part printed, of a printed publication entitled "Polynesian Artifacts" published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

September 18, 1959.

FLAM and FLAM
/s/ By FREDERICK FLAM
Attorneys for Defendant and
Cross-plaintiff.

Proof of Service by Mail Attached.

Admitted in Evidence December 15, 1959.

[Endorsed]: Filed September 21, 1959.

DEFENDANT'S EXHIBIT "P-4"

[Title of District Court and Cause.]

PLAINTIFF'S RESPONSE TO SECOND SUPPLEMENTAL REQUEST FOR ADMISSIONS

Ajax Hardware Manufacturing Corporation, the plaintiff herein, makes the following statements in response to the second supplemental request for admissions (third request for admissions) heretofore served upon it by the defendant.

Request No. 35

Defendant's Exhibit D, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff is unable to admit or deny this request, because the matter of the defendant's own drawer pull No. 555 is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 36

Defendant's Exhibit E, lodged herein, exemplifies a pull known by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Defendant's Exhibit "P-4"—(Continued)

Answer

Plaintiff is unable to admit or deny this request, because the matter of the defendant's own drawer pull No. 573 is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff.

Request No. 40

Defendant's Exhibit A, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge, and has been advised by Bassick-Sack, of Winston-Salem, N. C., that a pull identified by No. DC-9453 was originally designed in 1952 and sold in 1953.

Request No. 41

Defendant's Exhibit B, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge,

Defendant's Exhibit "P-4"—(Continued)

and has been advised by said Bassick-Sack that a pull identified by No. DC-9471 was originally designed in 1952 and sold in 1953.

Request No. 42

Defendant's Exhibit C, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge, and has been advised by said Bassick-Sack that a pull identified by No. DC-9459 was originally designed in 1952 and sold in 1953.

Request No. 43

Defendant's Exhibit D, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff is unable to admit or deny this request, because the matter of the defendant's own drawer pull No. 555 is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff, the said exhibit being a drawer pull allegedly manufactured and sold by the defendant.

Defendant's Exhibit "P-4"—(Continued)

Request No. 44

Defendant's Exhibit E, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff is unable to admit or deny this request, because the matter of the defendant's own drawer pull No. 573 is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff, the said exhibit being a drawer pull allegedly manufactured and sold by the defendant.

Request No. 45

Defendant's Exhibit F, lodged herein, exemplifies, a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge, and has been advised by Faultless Furniture Hardware, of Evansville, Indiana, that a pull identified by No. R-941 was designed in 1952; that drawings thereof were made and dated August 14, 1952; and that such a pull was first shown in the catalog of such company, dated January, 1955.

Defendant's Exhibit "P-4"—(Continued)

Request No. 46

Defendant's Exhibit G, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by No. R-960 was put into production in the Fall of 1952 and was first shown in the Faultless Furniture Hardware catalog of January, 1955.

Request No. 47

Defendant's Exhibit H, lodged herein, exemplifies a pull used by others in this country before the alleged invention of the subject matter of Design Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff has no knowledge when, if ever, said drawer pull was used by others in this country, but has used due diligence to obtain such knowledge, and has been advised by said Faultless Furniture Hardware that a pull identified by No. R-1042 was put into production in the Fall of 1952 and was first shown in the Faultless Furniture Hardware catalog in January, 1955.

Defendant's Exhibit "P-4"—(Continued)

Request No. 48

Defendant's Exhibit A, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 13, previously answered, and said answer applies hereto.

Request No. 49

Defendant's Exhibit B, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 15, previously answered, and said answer applies hereto.

Request No. 50

Defendant's Exhibit C, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Defendant's Exhibit "P-4"—(Continued)

Answer

This Request is substantially the same as Request No. 17, previously answered, and said answer applies hereto.

Request No. 51

Defendant's Exhibit D, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 27, previously answered, and said answer applies hereto.

Request No. 52

Defendant's Exhibit E, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This request is substantially the same as Request No. 30, previously answered, and said answer applies hereto.

Request No. 53

Defendant's Exhibit F, lodged herein, exemplifies a pull in public use in this country more than

Defendant's Exhibit "P-4"—(Continued)

one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 5, previously answered, and said answer applies hereto.

Request No. 54

Defendant's Exhibit G, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 1, previously answered, and said answer applies hereto.

Request No. 55

Defendant's Exhibit H, lodged herein, exemplifies a pull in public use in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 3, previously answered, and said answer applies hereto.

Defendant's Exhibit "P-4"—(Continued)

Request No. 56

Defendant's Exhibit A, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 14, previously answered, and said answer applies hereto.

Request No. 57

Defendant's Exhibit B, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 16, previously answered, and said answer applies hereto.

Request No. 58

Defendant's Exhibit C, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Defendant's Exhibit "P-4"—(Continued)

Answer

This Request is substantially the same as Request No. 18, previously answered, and said answer applies hereto.

Request No. 59

Defendant's Exhibit D, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 28, previously answered, and said answer applies hereto.

Request No. 60

Defendant's Exhibit E, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

Plaintiff is unable to admit or deny this request because the matter is particularly within the knowledge of the defendant and not within the knowledge of the plaintiff, the subject exhibit being a drawer pull allegedly manufactured and sold by defendant.

Defendant's Exhibit "P-4"—(Continued)

Request No. 61

Defendant's Exhibit F, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 6, previously answered, and said answer applies hereto.

Request No. 62

Defendant's Exhibit G, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

This Request is substantially the same as Request No. 2, previously answered, and said answer applies hereto.

Request No. 63

Defendant's Exhibit H, lodged herein, exemplifies a pull on sale in this country more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Defendant's Exhibit "P-4"—(Continued)

Answer

This Request is substantially the same as Request No. 4, previously answered, and said answer applies hereto.

Request No. 66

Defendant's Exhibit F-1, lodged herein, is a printed publication of Faultless Caster Corporation, published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Answer

If defendant's Exhibit F-1 is a small catalog of Faultless Caster Corporation, and not a large 8½ x 11 catalog having a black, white and red cover, this Request is admitted.

Request No. 68

Defendant's Exhibit J, lodged herein, is an accurate reproduction, part photostatic and part printed, of a printed publication entitled "Polynesian Artifacts" published more than one year prior to the date of the application for United States Letters Patent No. Des. 182,602 by Newton S. Leichter.

Defendant's Exhibit "P-4"—(Continued)

Answer

This Request is admitted, subject to correction in the typewritten part thereof if error should appear.

AJAX HARDWARE MANUFACTURING CORPORATION
/s/ By NORMAN D. LOUIS
President

State of California,
County of Los Angeles—ss.

Personally appeared before me, Norman D. Louis, President of Ajax Hardware Manufacturing Corporation, the plaintiff herein, and says that he has read the foregoing Plaintiff's Response to Second Supplemental Request For Admissions, and knows the contents thereof, and that the same are true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters he believes it to be true.

[Seal] /s/ MARTIN L. SKOLL,
Notary Public in and for said County and State.
My Commission Expires April 25, 1960.

Acknowledgment of Service Attached.

Admitted in Evidence December 15, 1959.

[Endorsed]: Filed September 28, 1959.

[Endorsed]: No. 16858. United States Court of Appeals for the Ninth Circuit. Jaybee Manufacturing Corporation, Appellant, vs. Ajax Hardware Manufacturing Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: April 13, 1960.

Docketed: April 15, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[Letterhead of Flam and Flam.]

April 13, 1960

Mr. Frank H. Schmid,
Clerk, U. S. Court of Appeals
P.O. Box 547
San Francisco 1, California

Re: Ajax Hardware Manufacturing Corporation vs. Jaybee Hardware Manufacturing Corporation
Civil Action No. 316-59 FK

Dear Sir:

There will be shortly transmitted to you from the District Court for the Southern District of California, Central Division, a record in the above case together with the $25.00 docket fee.

The record will contain a Statement On Points On Appeal Under Rule 75(d) and a Designation of Contents On Record On Appeal. For purposes of satisfying subdivision 6 of Rule 17, of the Rules of the Court of Appeals, the appellant wishes to adopt the Statement On Points On Appeal Under Rule 75(d) and Designation of Contents On Record On Appeal.

The record will also contain Exhibits 1, 5 and 6 which are soft copies of United States Design patents. The appellant has ordered sixty (60) copies of each of these patents. When received they will be forwarded for use as prescribed by subdivision 7 of Rule 17.

Respectfully,

/s/ FREDERICK FLAM,
FREDERICK FLAM,
For FLAM and FLAM.

FF-c

Certificate of Service by Mail Attached.

[Endorsed]: Filed April 14, 1960. Frank H. Schmid, Clerk.

No. 16,859

IN THE

United States Court of Appeals

For the Ninth Circuit

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii corporation, Trustee for the Creditors and Stockholders of PACIFIC REFINERS, LIMITED, a dissolved Hawaii corporation,

Appellant,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Hawaii.

BRIEF FOR APPELLANT

MARSHALL M. GOODSILL,
Bank of Hawaii Building,
Honolulu 1, Hawaii,
Attorney for Appellant.

ANDERSON, WRENN & JENKS,
Bank of Hawaii Building,
Honolulu 1, Hawaii,
Of Counsel.

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No. 16,859

IN THE

United States Court of Appeals

For the Ninth Circuit

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii corporation, Trustee for the Creditors and Stockholders of PACIFIC REFINERS, LIMITED, a dissolved Hawaii corporation,

Appellant,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Hawaii.

BRIEF FOR APPELLANT

OPINION BELOW

The decision of the District Court (R. 71) is reported at 178 F.Supp. 637.

JURISDICTION

This is a civil action commenced in the United States District Court for the District of Hawaii by Hawaiian Trust Company, Limited, a Hawaii corporation, as

Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation. Hawaiian Trust Company, Limited, Trustee as aforesaid, is hereinafter referred to as "taxpayer." Pacific Refiners, Limited is hereinafter referred to as "Refiners."

Taxpayer brought this action against the United States for the recovery of Internal Revenue taxes and interest alleged to have been erroneously and illegally assessed and collected. Taxpayer complied with the requirements of Sections 6532(a) and 7422(a) of the Internal Revenue Code of 1954 (and the predecessor sections of the 1939 Code), regarding suits for the recovery of any Internal Revenue tax, penalty or other sum.

The District Court had jurisdiction, regardless of the sum involved, under Title 28, U.S.C., Sections 1340 and 1346.

The District Court entered judgment dismissing the complaint on March 4, 1960. (R. 100.)

On March 11, 1960, taxpayer filed a notice of appeal. (R. 101.)

Jurisdiction is conferred on this Court by 28 U.S.C., Sections 1291 and 1294.

The pleadings necessary to show the existence of the jurisdiction are the complaint (R. 3) and the answer (R. 20).

QUESTIONS INVOLVED

Two questions are presented in this appeal, as follows:

First Issue: Whether Refiners was entitled to carry forward as a consolidated net operating loss to 1953 the net operating loss suffered in 1950 by its subsidiary, Hilo Gas Company, Limited.

Second Issue: Whether Refiners was entitled to deduct in 1955 Hawaii income taxes allocable to capital gains realized by it in 1955 but not recognized for Federal income tax purposes by reason of Section 337, Internal Revenue Code of 1954.

SUMMARY OF ARGUMENT

First Issue

Section 141(a), Internal Revenue Code of 1939, extends to an affiliated group of corporations the privilege of making a consolidated return. Refiners and Hilo Gas Company, Limited (hereinafter referred to as "Hilo Gas") became affiliated corporations prior to October 25, 1950, and met the statutory requirements for filing consolidated returns. Regulation 129, Section 24.11(c) provides that an affiliated group remains in existence as long as there is a common parent and at least one subsidiary remains affiliated with it. Accordingly, the affiliated group in this case remained in existence until Hilo Gas was dissolved in September, 1956.

A loss of $122,930.58 was sustained by Hilo Gas on the sale of its utility assets to Honolulu Gas Company, Limited (hereinafter referred to as "Honolulu Gas") on October 31, 1950. This loss took place on that date and not at any other time. This loss took place *after*

affiliation with Refiners. The loss was an ordinary loss. Consequently, under the Code (Sections 23(f), 117(j), 122 and 141 of the Internal Revenue Code of 1939), the income tax regulations and the consolidated return regulations, Hilo Gas was entitled to a deduction for this loss, and Refiners was entitled to include this loss in its consolidated net operating loss for 1950 and to carry it forward in full as a consolidated net operating loss carry-over to 1953.

Refiners acquired control of Hilo Gas for the purpose of obtaining an assured market in Hilo for butane to be manufactured in Refiners' new plant. There is no evidence to support the conclusion of the District Court (R. 98) that the principal purpose of the acquisition of Hilo Gas by Refiners was the evasion or avoidance of Federal income tax within the meaning of Section 129, Internal Revenue Code of 1939. The stipulated facts are that the principal purpose of the acquisition was a business purpose, unrelated to tax considerations.

Since Section 129 is not applicable and since there was a business purpose for the acquisition, the privilege of filing consolidated returns and carrying forward the net operating loss, which is granted by the plain terms of the statute and the regulations, cannot be denied to this taxpayer.

Second Issue

Hawaii income taxes allocable to gains realized by Refiners in 1955 on sale of its assets in accordance with its plan of liquidation, which gain was not recog-

nized for Federal income tax purposes by reason of Section 337, Internal Revenue Code of 1954, are deductible in full by Refiners under Section 164(a), Internal Revenue Code of 1954. Section 265 ("Expenses and Interest Relating to Tax Exempt Income") is not applicable because (1) non-recognized gains under Section 337 are not "income wholly exempt from taxes" and (2) this section disallows deductions for *expenses* but does not reach items deductible as *taxes.*

FIRST ISSUE: REFINERS WAS ENTITLED TO CARRY FORWARD AS A CONSOLIDATED NET OPERATING LOSS TO 1953 THE NET OPERATING LOSS SUFFERED IN 1950 BY HILO GAS.

FACTS

The facts in this case have all been stipulated by the parties. The Stipulation of Facts is printed in the Record at pages 25 to 52.

Refiners was organized as a corporation under the laws of the Territory of Hawaii on May 31, 1949. Refiners was dissolved on November 19, 1956, and Hawaiian Trust Company, Limited (taxpayer) was appointed Trustee for the creditors and stockholders in accordance with the laws of Hawaii. (Paragraph I, Stipulation of Facts, R. 25.)

Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in the Territory of Hawaii. Refiners was not a public utility, and none of its business was subject to regulation by the Public Utilities Commission of Hawaii. Refiners

entered into an oil and butane contract with Standard Oil of California (hereinafter called "Standard") in August of 1949 for a period of ten years for the purchase of petroleum oil and butane. The butane was blended by Standard into heavy gas oil and shipped to Refiners in Honolulu. Refiners at its refinery in Honolulu separated the butane from the gas oil. The butane thus obtained was liquefied and stored by Refiners in pressure tanks, ready for distribution and sale. The butane-free gas oil was then passed through a further process which removed diesel oil and similar fractions contained in the original oil, leaving asphalt. The gas oil was then sold to Honolulu Gas for its use in the manufacture of gas. Under this contract with Standard, Refiners was required to purchase a substantial minimum amount of heavy gas oil blended with butane. For the first contract year the minimum amounts were 450,000 barrels of oil and 650,000 gallons of butane; for the second year the minimum amounts were 500,000 barrels of oil and 1,450,000 gallons of butane; for each contract year thereafter the minimum amounts were 500,000 barrels of oil and 1,700,000 gallons of butane. The Hilo Gas distribution system, after its conversion to butane air in 1951, used in excess of 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners. (Paragraph III, Stipulation of Facts, R. 27-28.)

Hilo Gas was organized as a corporation under the laws of Hawaii in 1927. It engaged in the business of manufacturing gas from oil and distributing it through gas mains in the City of Hilo, Island of Hawaii. It was a public utility subject to regulation

by the Public Utilities Commission. In 1948 and 1949 the Company lost money and was in financial difficulty. In the spring of 1950 Mr. A. E. Englebright, who was then the general manager of Refiners, was approached by Mr. Orlando Lyman, the president and largest stockholder of Hilo Gas, for assistance in solving the problems of Hilo Gas. The proposition was made that Hilo Gas cease the manufacture of gas from oil and buy butane from Refiners, which Hilo Gas would then distribute through its gas mains in the City of Hilo as a public utility. This would save manufacturing costs and reduce gas rates to a point where they might be competitive with electric rates. The minutes of the Executive Committee of Refiners for May 10, 1950 state:

> "The General Manager and the Secretary reviewed the findings of their recent trip to Hawaii taken for the purpose of determining the best outlet for butane on that island. It was reported that the Hilo Gas Company wished to enter into an arrangement whereby they would convert their manufactured gas facilities to a butane-air or butane-vapor operation and that, in conjunction with this, they wished to obtain a franchise for the distribution of butane throughout the entire Island of Hawaii."

The feasibility of the Hilo Gas plan depended to some extent on the condition of its gas mains. Mr. Englebright sent Mr. L. L. Gowans, chief engineer of Honolulu Gas, to Hilo to make a survey. Mr. Gowans made a report, dated June 14, 1950, which concluded that the gas mains were in adequate condition and that it

would be entirely feasible and desirable to distribute a butane air mix in the Hilo Gas distribution system without too great a loss in leakage. After these reports and conversations with the principals, Refiners, on August 7, 1950, made a proposal to Mr. Lyman that it supply Hilo Gas with butane at 16¢ per gallon, based on the present posted price of butane in San Francisco. Refiners would also provide equipment and appurtenances for butane air installation at the Hilo plant at a cost of approximately $25,000, to be repaid by Hilo Gas through an additional 1¢ per gallon payment for all butane used in its system. Mr. Lyman expressed interest in this proposal, but in addition wished to acquire the franchise for distribution of "Isle-Gas" (Refiners' trade name for butane which it distributed in tanks or containers for use by rural customers) throughout the Island of Hawaii at the price quoted for use in the Hilo Gas mains. On August 31, 1950 Mr. Englebright wrote Mr. Lyman that Refiners could not "go along" with his proposal to include the North Hilo and Puna districts with Hilo proper for a combination utility and non-utility operation, with butane to be supplied at the price which Refiners had proposed for the Hilo Gas mains only. He said that Refiners was prepared to go ahead with the conversion proposal stated in the letter of August 7, but that it could not guarantee that Isle-Gas installations (which would be handled by other parties) would not compete directly with Hilo Gas service. This might be serious, said Mr. Englebright, as the cooking load (the only profitable load of Hilo Gas)

could be served more cheaply with Isle-Gas than with gas from the mains of Hilo Gas. Mr. Englebright suggested that it might be wisest for Hilo Gas to discontinue operations as a public utility (that is, distribution of gas through city gas mains) and instead convert all appliances of its customers to a butane-vapor operation, hooking them up to butane tanks (Isle Gas). He said that he thought that this would cost about $125,000, but would be a successful operation. This alternative proposal was not acceptable to Mr. Lyman. However, about the middle of September, 1950, Mr. Lyman offered to sell his stock in Hilo Gas to Refiners or to Honolulu Gas. With the exception of the foregoing negotiations with Refiners, neither Mr. Lyman nor any other of the stockholders or management of Hilo Gas had any plans for renovation or conversion of the Hilo Gas system or the abandonment or scrapping of the manufactured gas plant. (Paragraph IV, Stipulation of Facts, R. 29-31.)

On September 16, 1950 the Executive Committee of Refiners met to consider Mr. Lyman's proposal. The minutes of this meeting state:

> "The manager stated that we have been approached by the majority stockholder [Mr. Lyman] of the Hilo Gas Company with the proposal that he dispose to us his holdings of that Company, at a price that appeared to be advantageous from our standpoint. Another stockholder [Mr. Hutchinson] has slightly less than 30% of the balance of shares of Hilo Gas Company and it seems likely that they could be obtained for a reasonable price."

Mr. Englebright reviewed the advantages of the purchase of the Hilo Gas stock to provide an assured outlet for butane on the Island of Hawaii. He stated that in view of Refiners' commitment to Standard to purchase minimum amounts of butane, it was necessary or highly desirable to obtain this Hilo outlet, plus the non-utility business of Hilo Gas—the distribution of liquefied petroleum gas (called "Rock Gas") in tanks to rural customers beyond the city gas mains. Also, Refiners' new refinery was scheduled for completion in the fall of 1950 (actually completed in December), and it was necessary to find outlets for its butane production. Mr. Englebright stated that unless an attempt was made to perpetuate Hilo Gas, it would probably be dissolved (particularly as certain of its stockholders were also interested in the Hilo Electric Company), and this would serve as an obstacle to expanding gas sales, not only in Hilo, but also in other parts of the Island of Hawaii. Purchase of the stock would also assure Refiners of control of the non-utility ("Rock Gas"[1]) business of Hilo Gas in the outlying districts of the Island of Hawaii. Another meeting of the Executive Committee of Refiners was held on September 26, 1950, at which the Hilo Gas situation was discussed. On October 3, 1950 an option was obtained by Refiners from Mr. Lyman granting to Refiners an option to purchase his shares for $35,000 for a period of seven days from the date of the option, subject to the condition that the purchaser obtain options to pur-

[1]"Rock Gas" was the trade name for the liquefied petroleum gas distributed by Hilo Gas. It was substantially similar to and competitive with Refiners' product known as "Isle Gas".

chase not less than 75% of each of the outstanding classes of stock of Hilo Gas. There were 2,283 shares of 8% preferred stock, 1,929 shares of 7% preferred stock and no common stock outstanding. Both the 8% preferred stock and the 7% preferred stock were voting shares. Mr. Lyman owned 1,431 shares of the 8% preferred stock and 865 shares of the 7% preferred stock. Also on October 3, 1950, Refiners obtained a similar option from Mr. Hutchinson, who owned 747 shares of 8% preferred stock and 492 shares of 7% preferred stock, for a price of $18,832.80. On October 5, 1950 the Board of Directors of Refiners authorized the purchase by it of all of the stock of Hilo Gas. (Paragraph V, Stipulation of Facts, R. 31-34.)

The Hilo Gas stock was purchased by Refiners, rather than by Honolulu Gas, because Refiners, as the distributor of butane, had the primary interest in securing the Hilo market. On August 31, 1950 Mr. Englebright had recommended to Mr. Lyman that, as other solutions had failed, Hilo Gas should discontinue the distribution of gas through mains and distribute butane in tanks to customers. This would have resulted in a non-utility business of no interest to Honolulu Gas, but would have left Hilo Gas as a large butane customer of Refiners. Also, Refiners wished to acquire the non-utility "Rock Gas" business of Hilo Gas in outlying districts on the Island of Hawaii. Another reason for the purchase of the stock by Refiners, rather than by Honolulu Gas, was that an order of the Public Utilities Commission would have been necessary before Honolulu Gas could act to purchase the

stock, whereas no such order was required in the case of Refiners, which was not a public utility, and it was the view of the management of Refiners that quick action was necessary. Further, the purchase of Hilo Gas stock by Honolulu Gas would have made the latter company a public utility holding company under Federal law, a situation which Honolulu Gas wished to avoid. (Paragraph VI, Stipulation of Facts, R. 34-35.)

The stock of Messrs. Lyman and Hutchinson was sold to Refiners on October 6, 1950. At about the same time Refiners also purchased the largest blocks of stock held by other stockholders. On October 21, 1950 a letter was sent to the remaining stockholders of Hilo Gas offering to purchase their shares at the same price, and pursuant to this offer, Refiners purchased before October 25 most of the outstanding shares of both classes held by minority stockholders. Prior to October 25, 1950 Refiners had acquired 95% or more of the outstanding capital stock of Hilo Gas. Refiners never acquired more than 1,872 of the 1,929 outstanding shares of the 7% preferred stock of Hilo Gas and did not acquire the last minority-owned share of the 8% preferred stock until shortly before the dissolution of Hilo Gas in September, 1956. The total cost to Refiners of the Hilo Gas stock purchased by it was $63,897.20. (Paragraph VII, Stipulation of Facts, R. 35-36.)

Under the Hawaii law, no public utility may sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its road, line, plant system or other property necessary or useful

in the performance of its duties to the public without first having secured from the Public Utilities Commission an order authorizing it to do so, and every such sale, lease, assignment, mortgage, disposition or encumbrance made other than in accordance with the order of the Commission shall be void. (Sec. 104-18, RLH 1955.) On October 20, 1950 Hilo Gas filed a petition with the Public Utilities Commission in which it recited that it proposed to sell all of its assets, except its merchandise, goods, notes and accounts receivable related to the appliance sales business and its liquefied petroleum gas business, to Honolulu Gas for approximately $60,000, the exact price to be determined at its meeting of stockholders called to approve of such sale. The hearing on this application was held on October 26, 1950, at which the applicant presented its case. The Commission issued an order dated October 26, 1950, which was filed November 15, 1950, authorizing Hilo Gas to sell its utility assets to Honolulu Gas for a total consideration of approximately $64,000, consisting of a cash payment of approximately $46,000 and the assumption by the purchaser of outstanding utility liabilities in the amount of approximately $18,000. (Paragraph VIII, Stipulation of Facts, R. 36-37.)

Under the Hawaii law, the sale of substantially all of the property of a corporation requires the affirmative vote of three-fourths of all stock issued and outstanding and having voting power. (Sec. 172-30, RLH 1955.) At a meeting held October 31, 1950 the stockholders of Hilo Gas, by the necessary vote, authorized

the sale of the utility assets of the Company to Honolulu Gas and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950 Hilo Gas executed a bill of sale transferring to Refiners for $18,500 the merchandise, bottled gas and gas appliances and the notes and accounts receivable relating to the appliance sales business and the liquefied petroleum gas business. On October 31, 1950 Hilo Gas and Honolulu Gas executed an instrument whereby Hilo Gas conveyed to Honolulu Gas for $46,000 its utility manufacturing plant and equipment, its distribution system and utility assets, and Honolulu Gas assumed the liabilities of Hilo Gas. Possession of these assets was not taken by the purchasers until after October 31, 1950. (Paragraph IX, Stipulation of Facts, R. 37.)

On October 31, 1950, Hilo Gas sold utility assets to Honolulu Gas for $122,930.58 less than their net book value. Said utility assets sold to Honolulu Gas consisted of "property used in the trade or business" as defined in Section 111(j)(1), Internal Revenue Code of 1939. (Paragraph X, Stipulation of Facts, R. 37-38.)

After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas to Honolulu Gas, the necessary facilities for converting the Hilo system to butane air were ordered. The conversion of the system was completed in March of 1951, and on April 1, 1951 butane air gas was first supplied to the City of Hilo. Until April 1, 1951 all of the gas furnished to the City of Hilo was manufactured in the old plant

of Hilo Gas. The old plant was retained as a stand-by facility for a month or so after April 1, 1951 until it could be ascertained that the butane air system was operating properly. Thereafter, such of the manufacturing facilities of the old plant as were not used in the butane air system were abandoned, scrapped or transferred to the Honolulu Division of Honolulu Gas. The gas mains and distribution system of Hilo Gas were continued in use by Honolulu Gas. Hilo Gas had never claimed an obsolescence or abandonment loss for tax purposes on any of the utility assets sold by it to Honolulu Gas on October 31, 1950. (Paragraph XI, Stipulation of Facts, R. 38-40.)

As a result of the sale of said utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss of $117,792.57 for 1950. (Paragraph XII, Stipulation of Facts, R. 40.)

The taxable year of both Refiners and Hilo Gas was the calendar year. Refiners and Hilo Gas filed consolidated Federal income tax returns for the years 1950, 1951, 1952 and 1953. Refiners and Hilo Gas filed separate returns for the years 1954 and 1955. Both companies filed separate Territorial income tax returns for the years 1950-1955 inclusive. (Paragraph XIII, Stipulation of Facts, R. 40.)

In the year 1950 Refiners suffered a loss of $93,092. In 1951 it had a net income of $17,445 and in 1952 $39,147. It did not have to pay any Federal or Territorial income taxes in those years. In 1953 it had a

net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954 it had a net income before income taxes of $215,735.66 and after income taxes (as reported) of $104,977. All of the foregoing figures are on an unconsolidated basis. (Paragraph XIV, Stipulation of Facts, R. 40-41.)

At the time of the acquisition of the stock of Messrs. Lyman and Hutchinson on October 6, 1950, no consideration was given by Refiners to the tax aspect of the transaction. The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had been made to purchase the Lyman and Hutchinson stock. Mr. Lyman has stated that the principal purpose on taking over Hilo Gas was to sell butane not then used by Hilo Gas.

> "As far as I know no investigation was made into the accumulated losses of Hilo Gas or was the matter discussed at any time between Mr. Englebright and myself during the negotiations. The purpose of the purchase of Hilo Gas Co. was to do away with the old manufactured gas plant and replace it with Butane shipped in from Pacific Refiners." (Letter of August 27, 1956.)
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> "Mr. Englebright and I at no time discussed the book value of the assets of Hilo Gas Company.
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> "It is also my recollection that your accounting staff did not arrive in Hilo until the day I left the company after the sale. This timing I recollect as pay for my vacation time was left up to your staff. They refused payment. This incident, I be-

lieve, helps to place the correct timing of your accountant's access to the books. Mr. Englebright did not look over the books at any time before the purchase." (Letter of September 17, 1956.)

(Paragraph XVI, Stipulation of Facts, R. 41-42.)

It was not until November, 1950, that Refiners obtained advice on the tax aspects of the transaction. Mr. J. C. Rosebrook, the Treasurer of Refiners, consulted with Mr. H. C. Dunn, of Cameron, Tennent and Greaney, who wrote an opinion dated November 15, 1950 pointing out that the loss on the sale to Honolulu Gas would be an allowable deduction in a consolidated return filed by Refiners and Hilo Gas, but that this would not be an immediate benefit because Refiners did not have any net income. (Paragraph XVII, Stipulation of Facts, R. 42-43.)

Refiners included the net loss from the sale in October, 1950, of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carryover to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas. The Commissioner of Internal Revenue disallowed this item, resulting in a deficiency for the year 1953 of $58,472.39, plus interest of $11,301.99, which taxpayer has paid and is suing to recover. (Paragraphs XXII and XXIII, Stipulation of Facts, R. 46-48.)

ARGUMENT.

A. UNDER THE PLAIN TERMS OF THE STATUTE AND REGULATIONS REFINERS IS ENTITLED TO INCLUDE THE HILO GAS LOSS ON THE SALE OF ITS UTILITY ASSETS IN ITS CONSOLIDATED NET OPERATING LOSS FOR 1950 AND TO CARRY IT FORWARD AS A CONSOLIDATED NET OPERATING LOSS TO 1953.

Section 141(a), Internal Revenue Code of 1939,[2] extends to an affiliated group of corporations the privilege of making a consolidated return:

> "An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year in lieu of separate returns."

Section 141(d) defines an "affiliated group" as one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if the parent owns stock possessing at least 95% of the voting power of all classes of stock of the subsidiary. An "affiliated group" is formed at the time that the common parent corporation becomes the owner directly of stock possessing at least 95% of the voting power of another includible corporation.[3]

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[2]As the tax year involved in this issue is 1953, the 1939 Code is applicable rather than the 1954 Code. References in this section of the brief are, therefore, to the 1939 Code unless otherwise indicated.

[3]Income Tax Regulations 118, Section 39.141-1(b); Consolidated Return Regulations 129, Section 24.2(b)(3). The latter are reproduced at paragraph 58,201, CCH *Excess Profits Tax Reporter*, 3d ed.

Section 141(e) defines an includible corporation as any corporation except an exempt corporation and others, none of which exemptions or exceptions are applicable here.

Refiners and Hilo Gas became affiliated corporations prior to October 25, 1950 and met the statutory requirements for filing consolidated returns. There were two classes of voting stock of Hilo Gas—7% preferred and 8% preferred. Refiners purchased the stock of the two largest stockholders (Messrs. Lyman and Hutchinson) on October 6, 1950 and purchased the largest blocks of stock held by others at about the same time. Prior to October 25, 1950 Refiners had acquired more than 95% of the outstanding capital stock of Hilo Gas. (Paragraph VII, Stipulation of Facts, R. 35-36.)

Regulations 129, Section 24.11 (c) provides that an affiliated group of corporations remains in existence as long as there is a common parent and at least one subsidiary remains affiliated with it. Accordingly, the affiliated group in this case remained in existence until Hilo Gas was dissolved in September, 1956.

On October 31, 1950 Hilo Gas sold its utility assets to Honolulu Gas. Under the law of Hawaii this sale required the approval of the Hawaii Public Utilities Commission[4] and the approval of three-fourths of the

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[4]Section 104-18, Revised Laws of Hawaii 1955 (Section 4718, RLH 1945):

"*Merger and consolidation of public utility corporations.* No public utility corporation shall sell, lease, assign, mortgage

stockholders of Hilo Gas.[5] The approval of the Public Utilities Commission was obtained on November 26, 1950 and the necessary vote of the stockholders was obtained on October 31, 1950. The instrument conveying the utility assets to Honolulu Gas was executed and dated October 31, 1950. Under the law, the sale could not have taken place earlier. The sale took place *after* Hilo Gas and Refiners became "affiliated corporations" by reason of the acquisition of 95% of the Hilo Gas voting stock by Refiners sometime before

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or otherwise dispose of or encumber the whole or any part of its road, line, plant, system or other property necessary or useful in the performance of its duties to the public, or any franchise or permit, or any right thereunder, nor by any means whatsoever, directly or indirectly, merge or consolidate with any other public utility corporation without *first* having secured from the commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger or consolidation, made other than in accordance with the order of the commission shall be *void.*" (Emphasis added.)

[5]Section 172-30, Revised Laws of Hawaii 1955 (Section 8343, RLH 1945):

"*Voluntary transfer of corporate assets; notice to stockholders.* A voluntary sale, lease or exchange of all or substantially all of the property and assets of any domestic corporation including its good will, may be authorized by it upon such terms and conditions and for such consideration (which may be in whole or in part shares of stock in or other securities of, any other corporation or corporations, domestic or foreign) as its board of directors deems expedient, and for the best interests of the corporation, when and as authorized or approved by the affirmative vote or consent of the holders of not less than three-fourths of all stock issued and outstanding and having voting power or if it be a non-stock corporation, the affirmative vote or consent of three-fourths of its members. * * *

"* * * If the corporation is a public utility company within the meaning of chapter 104, such action shall require the prior approval of the public utilities commission, to be evidenced by a certificate of approval filed with the corporation."

October 25, 1950. (Paragraphs VII, VIII and IX, Stipulation of Facts, R. 35-37.)

Hilo Gas sold its utility assets to Honolulu Gas on October 31, 1950 for $122,930.58 *less* than their tax basis, resulting in a loss to Hilo Gas in this amount. This was a closed and completed transaction at that time. The gain or loss from the sale or other disposition of property is required to be recognized by Section 111. These assets (buildings and improvements, manufacturing plant and equipment, distribution system and related facilities) consisted of "property used in the trade or business" as defined in Section 117(j)(1). (Paragraph X, Stipulation of Facts, R. 37-38.) The loss suffered by Hilo Gas was an ordinary loss. Section 117(j)(2) provides that if gains upon sales or exchanges of property used in the trade or business do *not* exceed losses from such sales or exchanges, such losses shall *not* be considered as losses from the sale of capital assets—in other words the losses are ordinary losses. Section 23(f) allows a corporation a deduction for losses sustained during the taxable year. Section 122 provides for the computation and carry over of a net operating loss. Under these sections Hilo Gas had a net operating loss for 1950 of $117,792.57 (Paragraph XII, Stipulation of Facts, R. 40) which, after adjustment for small intervening profits of Hilo Gas, resulted in a net operating loss carry over to 1953 of $116,405.64. (Paragraph XXII, Stipulation of Facts, R. 46-48.)

Refiners and Hilo Gas filed consolidated income tax returns for the years 1950 to 1953, inclusive. (Para-

graph XXIII, Stipulation of Facts, R. 48.) In case a corporation is a member of an affiliated group for a fractional part of a year, the consolidated return shall include the income (or loss) of such corporation for the part of the year during which it is a member of the group. Section 141(a), last sentence; Reg. 118, Section 39.141-1(c); Reg. 129, Section 24.13(b) and (d); Reg. 129, Section 24.32. Under Reg. 129, Sec. 24.31(a), the consolidated net operating loss deduction for the affiliated group must be computed by combining the net operating losses of the several affiliated corporations having net operating losses, including carry overs and carry backs. Thus, the consolidated returns filed for Refiners and Hilo Gas for 1950 properly included the loss suffered by Hilo Gas *after* the affiliation. Under Sections 122 and 141 of the Code and the Consolidated Return Regulations (Section 24.31), Refiners was entitled to carry the 1950 consolidated net operating loss forward to 1953, which was the first year in which there were sufficient consolidated profits to absorb the loss. (Paragraphs XIV and XV, Stipulation of Facts, R. 40-41.)

The loss which was incurred and recognized when Hilo Gas sold its utility assets to Honolulu Gas for a price less than their tax basis is a net operating loss sustained by Hilo Gas. Under the plain terms of the foregoing provisions of the statute and regulations, the Hilo Gas net operating loss in 1950 can be carried forward by Refiners in consolidated returns to the year 1953. Indeed, the Government has never suggested that the loss carry forward did not come within

the literal terms of the statute and the regulations, nor did the District Court make any such finding. Indeed, it is implicit in the District Court's decision that *despite* the fact that the taxpayer and Hilo Gas fall within the loss recognition, carry forward, and consolidated return provisions, nevertheless the loss carry forward may be denied because of the collateral considerations, primarily the applicability of Section 129. (R. 86.)

B. SECTION 129 IS NOT APPLICABLE BECAUSE THE PRINCIPAL PURPOSE OF THE ACQUISITION OF HILO GAS BY REFINERS WAS A BUSINESS PURPOSE, NOT THE EVASION OR AVOIDANCE OF TAXES.

The decision of the District Court denying the loss carry forward is based primarily on the conclusion that "Refiners has not established that the principal purpose for the acquisition of Hilo Gas was not for evasion or avoidance of Federal income tax," within the meaning of Section 129, Internal Revenue Code of 1939.

Section 129 provides:

> "(a) *Disallowance of Deduction, Credit, or Allowance.*—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation * * * and the *principal purpose* for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such

> person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed." (Emphasis added.)

We think it is apparent from a reading of the Stipulation of Facts in this case that the District Court erred in reaching this conclusion. It would be difficult to find a case where the business purpose is more clearly established than here or where there was less of a tax evasion or avoidance purpose. The facts are all stipulated. There is no conflict in the evidence. There is no evidence at all to support the District Court's conclusion that the principal purpose of the acquisition was tax evasion or avoidance. The District Court's conclusion flies in the face of the stipulation of the parties that "at the time of the acquisition of the stock of Messrs. Lyman and Hutchinson [the controlling stock of Hilo Gas] on October 6, 1950 no consideration was given by Refiners to the tax aspects of the transaction." (Paragraph XVI, Stipulation of Facts, R. 41-42.) The evidence, and it is affirmative evidence not merely negative evidence, or the absence of evidence, establishes that the purpose of the acquisition was a business purpose.

Section 129 takes effect only if *the principal purpose* for which the acquisition was made is the evasion or avoidance of Federal income or excess profits taxes. The statute says this about as clearly as a statute can say anything. The Regulations say so: "*The principal purpose* for which the acquisition was made *must* have been the evasion or avoidance of Federal

income or excess profits tax." (Emphasis added.) Reg. 118, Section 39.129-3(a). The Senate Committee Report makes it even clearer: "The House bill made Section 129 operative if *one* of the principal purposes was tax avoidance. Your committee believes that the Section should be operative *only* if the evasion or avoidance *outranks,* or *exceeds in importance,* any other one purpose." (Emphasis added.) S. Rep. No. 627, 78th Cong., 1st Sess., pp. 59-60; 1944 *Cum. Bull.* 973, at p. 1017. This point has been specifically considered by the Tax Court which has held that: "The tax avoidance purpose must exceed in importance any other purpose to constitute the 'principal purpose.'" *Commodores Point Terminal Corp.,* 11 T.C. 411, 418 (1948)(A). A leading tax textbook states:

> "For the provision to apply, the *principal* purpose of the acquisition must be to secure to the acquiring corporation a benefit from the use of a tax deduction, credit, or allowance which it would not otherwise enjoy. Moreover, even if there is a tax-saving motive, the prohibitions do not apply, so long as the principal purpose is a legitimate business one. A taxpayer is not expected to shun a legitimate and profitable business transaction because an incidental result would be a substantial tax saving." (Emphasis added.) *Montgomery, Federal Taxes* 7:57 (36th ed., Ronald Press, 1955).

What was the principal purpose of the acquisition of control of Hilo Gas by Refiners? To obtain a market for the butane to be produced in Refiners' new plant, construction of which was completed in December,

1950. Under its contract with Standard Oil Company, Refiners was required to purchase a very substantial minimum amount of crude oil blended with butane: for the first year, 450,000 barrels of oil and 650,000 gallons of butane; for the second year, 500,000 barrels of oil and 1,450,000 gallons of butane; for each of the eight years thereafter, 500,000 barrels of oil and 1,700,000 gallons of butane. Refiners ascertained that it was feasible to convert the manufactured gas distribution system of Hilo Gas to butane air, which would make Hilo Gas a very large butane customer. The Hilo Gas distribution system, after its conversion to butane air in 1951, used in excess of 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners. In presenting the matter of the acquisition of Hilo Gas to his Board of Directors on September 16, 1950, Mr. Englebright (manager of Refiners) reviewed the advantages of the purchase of the Hilo Gas stock to provide an assured outlet for butane on Hawaii. He stated that in view of Refiners' commitment to Standard to purchase minimum amounts of butane, it was necessary or highly desirable to obtain this Hilo outlet, plus the non-utility business of Hilo Gas—the distribution of liquefied petroleum gas ("Rock Gas") in tanks to rural customers beyond the city gas mains. Also Refiners' new plant was scheduled for completion that fall and needed an outlet for butane production. Unless an attempt were made to perpetuate Hilo Gas, it would probably be dissolved and this would serve as an obstacle to expanding gas sales in Hilo and

other parts of the Island of Hawaii. All these facts are stipulated. (Paragraphs III, IV and V, Stipulation of Facts, R. 27-34.)

The reasons why Hilo Gas was acquired by Refiners rather than by Honolulu Gas are because, Refiners, as the distributor of butane, had the primary interest in securing the Hilo market (Mr. Englebright had even suggested at one point in the negotiations that Hilo Gas give up its utility business and supply its customers with butane in tanks supplied by Refiners, which would have resulted in a non-utility business of no interest to Honolulu Gas); because Refiners wished to acquire the non-utility "Rock Gas" business in rural districts on the Island of Hawaii; because an order of the Public Utilities Commission would have been necessary before Honolulu Gas could act to purchase the stock whereas no such order was required in the case of Refiners which was not a public utility[6] and quick action was necessary; because the purchase of Hilo Gas stock by Honolulu Gas would have made

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[6]Section 104-17, Revised Laws of Hawaii, 1955 (Section 4717 RLH 1945) provides:

"§104-17. *Acquirement of stock of another public utility.* No public utility corporation shall purchase or acquire, take or hold, any part of the capital stock of any other public utility corporation, organized or existing under or by virtue of the laws of the Territory, without having been first authorized to do so by the order of the commission. Every assignment, transfer, contract or agreement for assignment or transfer of any stock by or through any person or corporation to any corporation or otherwise in violation of this section shall be void and of no effect; and no such transfer shall be made on the books of any public utility. Nothing herein contained shall be construed to make illegal the holding of stock lawfully acquired before July 1, 1933."

the latter a public utility holding company under Federal law, a situation which Honolulu Gas wished to avoid. (Paragraph VI, Stipulation of Facts, R. 34-35.)

It has also been stipulated that at the time of the acquisition of the controlling interest (stock of Messrs. Lyman and Hutchinson) in Hilo Gas no consideration was given by Refiners to the tax aspects of the transaction; that the officials of Refiners did not then know what the book value of the Hilo Gas assets was; that the Hilo Gas books were not made available to Refiners until *after* the decision had been made to purchase the controlling stock interest. (Paragraph XVI, Stipulation of Facts, R. 41-42.)

Refiners was prepared to and did purchase the Hilo Gas stock without knowing or caring whether subsequent sales of Hilo Gas utility assets would result in a gain or loss to Hilo Gas. Refiners did not consider the tax aspects of the transaction until November, 1950, the month *after* it had acquired control of Hilo Gas. (Paragraph XVII, Stipulation of Facts, R. 42-43.) The acquisition of Hilo Gas was not a transaction motivated by tax considerations; rather it was a transaction motivated by business considerations where taxes were not even considered until *after* the transaction was completed. Any tax benefit to Refiners which might result from the transaction was an afterthought, an unanticipated windfall.

If the principal purpose of the acquisition had been tax evasion or avoidance Refiners would have made it a condition of its agreement to purchase the Lyman

and Hutchinson stock that it be able to acquire 95% of the outstanding stock of each class, that being the amount required for it to file consolidated returns and to use any Hilo Gas loss suffered after the affiliation. However, Refiners made no such condition and agreed to buy the Lyman and Hutchinson stock without knowing whether it could acquire 95% of all the stock. The requirement that Refiners obtain 75% of the stock was a condition of the seven day option imposed by Lyman, not Refiners. (Paragraph V, Stipulation of Facts, R. 31-34.) Refiners bought and paid for the Lyman and Hutchinson stock on October 6, 1950, this being about 75% of the total of each class, but it was not until after its letter to the other stockholders dated October 21, 1950, that Refiners acquired enough additional stock to bring its total above 95%. (Paragraphs V and VII, Stipulation of Facts, R. 31-34; 35-36.) If this was in fact a "tax scheme" it is extremely odd that Refiners would have paid out $53,832 to Lyman and Hutchinson without having any assurance that it could get enough of the balance of the stock to complete the scheme.

In 1950, Refiners had a loss of $93,092. In 1951, it had a before-tax income of $17,445 and in 1952 a before-tax income of $39,147. Because of its own 1950 loss carry-over it had no income taxes to pay until 1953. (Paragraph XIV, Stipulation of Facts, R. 40-41.) In October, 1950 the future of Refiners was, at best, highly speculative. It is hardly likely that Refiners would have spent any money buying Hilo Gas stock for the purpose of acquiring an operating

loss carry forward. It had almost a $100,000 loss already and no offsetting income. It needed to acquire operating income, not further operating losses. If the corporate officials involved had considered the tax aspects of the transaction or possible tax benefits, it seems obvious that they would have recommended that the acquisition be by Honolulu Gas, an established, profitable business which could use an operating loss, rather than by Refiners. For example, Honolulu Gas might have acquired 95% of the stock of Hilo Gas and filed consolidated returns; during the consolidated return period Hilo Gas could have sold, abandoned or taken obsolescence losses on portions of the manufactured gas plant and Honolulu Gas could have immediately used such losses against its income. Under the circumstances, the acquisition by Refiners in itself shows that there was here no intent to evade or avoid taxes.

When consideration is given to the foregoing facts, it is impossible to conclude that the "principal purpose" for the acquisition of Hilo Gas was the evasion or avoidance of income taxes. The taxpayer's purpose must be determined as of the time the acquisition was made and not in the light of later events. When this acquisition was made, taxes were not a factor at all; tax evasion was not any part of the purpose of the acquisition, principal or otherwise. The principal purpose of the acquisition was to obtain the Hilo market for butane. The secondary purpose was to acquire the "Rock Gas" distribution business on the Island of Hawaii. There was no other purpose.

The District Judge draws from the record only *one fact* to support his conclusion—that Hilo Gas lost money in 1948 and 1949 and was in financial difficulty. "In such a situation, it has been held that the principal purpose of the acquisition was the avoidance of Federal income taxes," citing *Elko Realty Co.,* 29 T.C. 1012 (1958), *aff'd* per curiam 260 F.2d 949 (3d Cir. 1958). (R. 88.) The fact that Hilo Gas had lost money in 1948 and 1949 and was in financial difficulty in no way proves that the purpose of the acquisition was tax evasion or avoidance unless it can be shown that the losses had produced an operating loss to be carried forward, that the purchaser knew about this, and that this was the principal reason for the purchase. None of these things can be shown here; indeed, the evidence shows affirmatively that the facts were otherwise. The loss which Refiners has sought to carry forward here is not a loss suffered by Hilo Gas in prior years. Although Hilo Gas may have had a loss in 1948 and 1949 this was of no significance to Refiners which made no attempt to carry forward such losses against its profits and could not have done so in any case under the Consolidated Return Regulations.[7] In 1950 Hilo Gas had an operating profit of $5,138 outside of the loss suffered on sale of assets. (Paragraph XXII, Stipulation of Facts, R. 46-48.)

The loss which Refiners has sought to carry forward here is a loss suffered by Hilo Gas *after* affiliation,

[7]Reg. 129, Section 24.31(a)(3) provides that a loss sustained by a subsidiary *prior* to affiliation cannot be used against the parent's profits after affiliation.

when it sold its utility assets to Honolulu Gas for a consideration which was $122,930 less than the net book value and tax basis of these assets. (Paragraph X, Stipulation of Facts, R. 37-38.) This loss had nothing to do with whether Hilo Gas had suffered losses in 1948 and 1949 and was in financial difficulty. The loss could have been anticipated and planned for tax-wise only *if* the officials of Refiners had had access to the books of Hilo Gas before the acquisition of control so that they could have ascertained the book value and tax basis for the utility assets, the amount of depreciation which had been taken, whether obsolescence or abandonment losses on these assets had already been claimed, and the amount of the unrecovered "tax cost" of these assets. With this information, Mr. Englebright might have been able to anticipate a tax saving; without it he could not possibly have known whether or not there was any tax advantage to be gained from acquiring control of the Hilo Gas utility assets. What then are the facts with respect to this information?

The facts are set forth clearly in Paragraphs XVI and XVII of the Stipulation of Facts (R. 41-43):

> "At the time of the acquisition of the stock of Messrs. Lyman and Hutchinson on October 6, 1950, no consideration was given by Refiners to the tax aspects of the transaction. The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had been made to purchase the Lyman

and Hutchinson stock. Mr. Lyman has stated that the principal purpose on taking over Hilo Gas was to sell butane not then used by Hilo Gas.

> 'As far as I know no investigation was made into the accumulated losses of Hilo Gas or was the matter discussed at any time between Mr. Englebright and myself during the negotiations. The purpose of the purchase of Hilo Gas Co. was to do away with the old manufactured gas plant and replace it with Butane shipped in from Pacific Refiners.' (Letter of August 27, 1956)
>
> 'Mr. Englebright and I at no time discussed the book value of the assets of Hilo Gas Company.
>
> 'It is also my recollection that your accounting staff did not arrive in Hilo until the day I left the company after the sale. This timing I recollect as pay for my vacation time was left up to your staff. They refused payment. This incident, I believe, helps to place the correct timing of your accountant's access to the books. Mr. Englebright did not look over the books at any time before the purchase.' (Letter of September 17, 1956)
>
> "It was not until November, 1950, that Refiners obtained advice on the tax aspects of the transaction."

The *Elko Realty* case, *supra,* which is the only authority cited by the District Judge to sustain his decision, dealt with quite a different situation. In *Elko* there was no purpose for the acquisition aside from

the tax purpose of acquiring an operating loss. The Tax Court found that "no bona fide business purpose was served by the acquisition." (29 T.C. 1018.) Fox, the principal owner (80%) of Elko Realty Co., was an experienced real estate and mortgage operator. Without making any investigation of the earnings, on January 1, 1951, he acquired all the stock of two FHA financed apartment corporations from the owner, Harry Spiegel, for $15,800. He then transferred the stock to Elko Realty for 9 shares of Elko having a stated value of $900. At the time of the acquisition, the two apartments were operating at a loss and continued to operate at a loss in 1951, 1952 and 1953. In 1954 the FHA foreclosed the mortgages. The losses suffered in 1951, 1952 and 1953 were the same kind of operating losses previously suffered; the pattern of losses remained constant. At the time of the acquisition, Fox knew that the apartment corporations had no working capital and he was aware that most of his purchase money went to pay mortgage obligations of one of the apartment corporations which was in default. Fox was the only witness in the case; the Tax Court observed that his testimony was "unclear and at times inconsistent, although Fox himself conducted the negotiations and the facts of the transaction were peculiarly within his own knowledge." Fox had no reasonable basis for believing that the two apartment corporations were operating successfully. He failed to furnish any convincing evidence that the two acquisitions had as their principal motivation a bona fide business purpose. One of his two "business" reasons

was obviously without substance—to have Elko Realty earn rental and insurance commissions from the two apartment corporations. When Fox had himself bought the stock of the two apartment corporations he could have placed the commissions in the hands of Elko if that was the desired objective, without transferring the stock to Elko. Acquisition of the stock by Elko added nothing to the substance of its ability to secure the commissions. The other "business" reason was that Elko would own two valuable pieces of property when the mortgages were paid off. Since the apartments were unprofitable and the mortgages could not be paid off (and were in fact foreclosed in 1954), this reason also was without substance. In fact there was no reason for an experienced operator like Fox to acquire the apartment corporations except to use their continuing operating losses against the profits of Elko. The Tax Court concluded:

> "Under the circumstances, for petitioner [Elko] to expect us to give serious credence to its assertion that through Fox, a thoroughly experienced businessman, it entered into the transaction in question for a bona fide business purpose requires a degree of naivete which we do not possess." (29 T.C. 1025)

The differences between this case and ours are striking. First, Refiners was a publicly held company (Paragraph II, Stipulation of Facts, R. 25-27) not a privately owned corporation which could be manipulated for tax purposes like the three corporations in *Elko, supra.* Second, the loss in our case is not a con-

tinuation of the pattern of normal operating losses which could have been anticipated by the purchaser without looking at the books, as the Tax Court found the apartment losses to be, but rather a loss on a sale of utility assets which could not have been anticipated without knowledge of their tax basis to be gathered from the books or from inquiries made of the Hilo Gas management, neither of which took place. Third, the Tax Court could not believe that Fox did not know about the financial conditions of the apartment corporations before he bought the stock, in view of his experience, his knowledge of the lack of working capital, his knowledge of the default in the mortgage and the other circumstances. In our case, unless there were in fact tax motives, there was no reason why the officers of Refiners should inquire about the tax basis of the Hilo Gas property or look at the books before the stock was acquired. The officers of Refiners were not interested in acquiring a tax loss (Refiners already had one of its own of almost $100,000). They knew the approximate current value of the Hilo Gas utility assets from the recent report of their own engineer (Paragraph IV, Stipulation of Facts, R. 29-31) so they did not need to inspect the books to determine if the price placed by Mr. Lyman on his stock was reasonable. Fourth, Fox was an unclear and inconsistent witness. There is nothing unclear or inconsistent about the stipulated facts in our case. Fifth, in our case it has been stipulated that "no consideration was given by Refiners to the tax aspects of the transaction" at the time of the acquisition. (Paragraph XVI, Stipula-

tion of Facts, R. 41-42.) No such fact was stipulated or proved in *Elko, supra.* Sixth, there was no rational or bona fide business purpose for Elko's acquisition of the stock of Spiegel's apartments, whereas in our case there are sound and legitimate business reasons for Refiners' acquisition of Hilo Gas. The fact that Refiners had to purchase 650,000 to 1,700,000 gallons of butane a year from Standard, and that it was able to sell 500,000 gallons a year in the Hilo Gas system (Paragraph III, Stipulation of Facts, R. 27-28) is alone sufficient to justify the acquisition as a business matter.

The District Judge appears to accept the argument of the government that the fact that Refiners bought stock for $63,897 and shortly thereafter Refiners sold its assets for $88,754 is in itself a reason for denying the loss carry forward. (R. 87.) The idea seems to be that the fact that Refiners did not pay something for a tax loss it did not know it was getting is fatal to its case. A short answer to this is that there is nothing in the law which outlaws windfalls. Taxpayers frequently have unexpected tax windfalls, just as they sometimes fall into unexpected tax traps. Unless there is some section of the law which prevents Refiners from using the tax loss (such as Section 129 which would prevent it *if* the principal purpose of the acquisition were in fact tax evasion or avoidance), Refiners is entitled to the advantage afforded by the loss recognition, carry forward and consolidated return provisions. The following quotation from the decision of the Supreme Court in *Lewyt Corp. v. Commis-*

sioner, 349 U.S. 237 (1954) where the taxpayer was the beneficiary of an unexpected net operating loss benefit of some $304,000 which cost it nothing, is apposite:

> "But the rule that general equitable considerations do not control the measure of deductions or tax benefits cuts both ways. It is as applicable to the Government as to the taxpayer. Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall." (At p. 240.)

Moreover, let us examine the facts more closely. Most of the Hilo Gas stock was acquired on October 6, 1950. Twenty-five days later Hilo Gas sold its assets, after approval of the Public Utilities Commission. If the PUC had refused approval, Refiners would have been left with its full investment of $63,-897.20 unrecovered; there was no contract or legal obligation of Honolulu Gas to purchase the utility assets. The utility assets were in fact sold to Honolulu Gas for $46,000 cash and assumption by Honolulu Gas of liabilities of Hilo Gas in the amount of $25,254. At that point Refiners was still "out of pocket" $17,-896 ($63,897 minus $46,000), assuming all of the $46,000 could be treated as belonging to it. Refiners then purchased non-utility assets of Hilo Gas (bottled

gas, gas appliances, accounts receivable, etc.) from Hilo Gas for $18,500 in cash. (Paragraphs VII, VIII, and X, Stipulation of Facts, R. 35-38.) Thus, Refiners had a fair amount of cash at risk in the Hilo Gas purchase. At that time Refiners had had nothing but operating losses (about $100,000) and every dollar of cash was needed to build the refinery and get the business going. Management's presentation of the reasons for the Hilo Gas investment did not include potential tax benefits. (Paragraph V, Stipulation of Facts, R. 31-34.) As noted above, Refiners was a publicly held company. Its directors, being trustees of the stockholders' money, would hardly have authorized the management to make a cash outlay to purchase Hilo Gas stock if the "principal purpose" of the acquisition was a tax speculation.

As a matter of fact, the payment by Refiners of an amount approximating what the Hilo Gas assets were worth, rather than an amount which included an additional consideration for a potential tax benefit, indicates that neither Refiners nor the Hilo Gas stockholders had any idea of potential tax benefits at the time of acquisition. In commenting on Section 269(c) (the presumption added by the Internal Revenue Code of 1954, which applies only to acquisitions after March 1, 1954) tax writers have pointed out that a purchase for a price substantially equivalent to fair market value indicates that the purchaser had no thought of tax advantages, rather than vice versa:

> "Two problems result from the presumption created by section 269. First, there is ordinarily

> no real relation between the basis of the corporate assets and the purchase price paid for the stock. The price is much more likely to be related to net asset value. If we assume a corporation with an asset basis of $100 but a value of $50, a purchase for $50 is less likely to be motivated by tax purposes than a purchase in excess of value which might be motivated by the high depreciation allowance. Thus, if the purchaser has no thought of the tax advantages, he may run into the section 269 presumption simply by having failed to take them into account. Ironically enough, then, it may be easier to overcome the prima facie evidence of disproportionate purchase price the more disproportionate the price may be." Cohen, Phillips, Surrey, Tarleau, Warren, "The Internal Revenue Code of 1954: Carry-Overs and the Accumulated Earnings Tax," 10 *Tax L. Rev.* 277, 295-296 (March 1959)

The 1959 report of the Committee on General Income Tax problems of the Section of Taxation of the American Bar Association suggested revising Section 269(c) to provide that if the consideration paid is substantially greater than the net fair market value of the property acquired, then there shall be a presumption of tax evasion or avoidance. In commenting on this, the Committee stated:

> "Presumably the correspondence of purchase price to the net value of the assets required would indicate that the acquisition of the assets was not undertaken primarily to acquire a tax benefit. The American Law Institute adopted this approach in its model income tax statute. A.L.I.

Federal Income Tax Statute, Tenative Draft No. 7, Section X661." American Bar Association, *1959 Report of Section of Taxation*, at p. 79.

If good business reasons for the acquisition exist the presence or absence of a tax saving motive is immaterial. The decisions under Section 129 make it clear that the section does not apply *even if there is a tax saving motive* so long as the principal purpose is a legitimate business purpose. If the purpose of a transaction is legitimate, the accompanying tax avoidance purpose is legally neutral. The Commissioner has been consistently unsuccessful in trying to invoke Section 129 when a legitimate business purpose was present, *even though a tax saving purpose was concededly present in each of these cases.* Following is a list of these cases showing the business reasons which were found to be present. Note that in a large number of the Tax Court cases the Commissioner has *acquiesced* in the decision. *Alprosa Watch Corp.*, 11 T.C. 240 (1948) (the acquisition of an existing corporation was necessary to market Pierce watches); *Alcorn Wholesale Co.*, 16 T.C. 75 (1951)(A) (reasons for splitting into five corporations were to increase combined borrowing capacity, to limit liability for tort judgments, to permit handling of competitive lines of merchandise, to eliminate prejudice against absentee ownership); *Berland's, Inc.*, 16 T.C. 182 (1951)(A) (branch stores incorporated separately so that parent would not be liable for lease rentals); *Chelsea Products, Inc.*, 16 T.C. 840 (1951) (*Aff'd* in part 197 F.2d 620) (sales companies organized and operated to reduce tort lia-

bility, to establish local operators, to save freight charges); *Commodores Point Terminal Corp.,* 11 T.C. 411 (1948)(A) (stock control of Piggly Wiggly Co. acquired to secure dividend income which would provide funds for repairs of facilities and interest payments on mortgage bonds); *W A G E, Inc.,* 19 T.C. 249 (1952)(A) (merger of radio station into auto dealer to make available liquid assets for broadcasting business); *Dilworth Co. v. Henslee,* 98 F.Supp. 957 (M.D. Tenn. 1951) (Tennessee corporation formed Mississippi corporation to conduct Mississippi operations—State purchasing authorities and other Mississippi customers preferred to deal with local corporation; Mississippi State taxes could be more easily determined with separate corporation); *John P. Wagner,* 17 CCH Tax Ct. Mem. 569, 614 (1958) (because cost of insurance was prohibitive four corporations were organized to minimize the risk of liability); *Virginia Metal Products, Inc.,* 33 T.C. ....., No. 88 (1960) (acquisition of stock of Arlite was for a bona fide business purpose of getting into the aluminum window and partition business and the Commissioner erred in disallowing a net operating loss carry over in the consolidated return). With respect to tax purposes the Tax Court has said:

> "As pointed out in Treasury regulations and in the reports of the committees of Congress, a tax avoidance purpose incidental to such a transaction does not necessarily bring it within the condemnation of section 129. The tax avoidance purpose must exceed in importance any other purpose to constitute the 'principal purpose.' The

> fact that Lovett may have made a tax saving is of no moment." *Commodores Point Terminal Corp.,* 11 T.C. at p. 418.
>
> "The consideration of the tax aspects of the plan was no more than should be expected of any business bent on survival under the tax rates then current. Such consideration is only the part of ordinary business prudence. It does not follow automatically from the fact that tax consequences were considered, that tax avoidance was the principal purpose of Berlands' organization of the petitioning corporations." *Berland's, Inc.,* 16 T.C. at p. 188.

As a matter of fact, the Commissioner had so little success in establishing a principal tax purpose where a business purpose was also present that Congress added Section 269(c) to the 1954 Code to give him a helping hand. The Senate Finance Committee commented: "The effectiveness of this provision [Section 129] has been impaired by the difficulty of establishing whether or not tax avoidance was the principal purpose of the acquisition." S.Rep. No. 1622, 83d Cong., 2d Sess., at p. 39. See also 7 Mertens, *Law of Federal Income Taxation,* Section 38.69. Section 269(c) is not applicable here because by its terms it applies only with respect to acquisitions after March 1, 1954. As we are dealing with the old law, it is evident not only that the presumption introduced by Section 269 (c) cannot be used to aid the Government, but also that all of the difficulties which the Commissioner encountered in trying to apply Section 129 are present in our case.

In its brief below the Government relied on *American Pipe & Steel Corp.*, 25 T.C. 351 (1955) *aff'd* 243 F.2d 125 (9th Cir. 1957), *cert. denied* 355 U.S. 906 (1957). Although the District Judge did not cite the case, it is a leading one in the field and should be considered here. We believe that the predominant tax purpose of the acquisition in *American Pipe* and the almost complete absence of business purpose distinguish this case from ours.

American Pipe was engaged in the steel fabricating business. Stock control was in Lane (President) and Krieger (Secretary and Treasurer). With the onset of World War II, American Pipe was on the threshold of obtaining many profitable government contracts and its prospective profits "loomed large." Palos Verdes Estates, Inc., a real estate company, had been in poor financial condition since 1936 and was not actively engaged in business. Its principal assets were 695 unsellable residential lots, with a tax basis in excess of $430,000 and a market value of about $25,000. Lane had been long familiar with the real estate in the Palos Verdes area, having maintained a real estate broker's office four miles to the north. In the spring of 1942 Archer, a real estate broker, informed Lane of the Palos Verdes situation. Lane made an "exhaustive study" of the lots owned by Palos Verdes. In July of 1942 Archer joined American Pipe, ostensibly as an "expediter" and "accountant." In fact he was used as a middleman to acquire stock of Palos Verdes for American Pipe. Promptly after acquiring control, American Pipe caused Palos Verdes to sell

its lots at a loss, mostly to a friend of Lane who was financed by American Pipe. The taxpayer argued that there was a business purpose for the acquisition, citing a letter from Lane to his stockholders saying the acquisition would enable American Pipe to improve its position in the sale of pipe and casing in real estate developments and would provide an organization for marketing postwar metal houses. When it is remembered that Palos Verdes was practically a defunct organization with only three employees (two, part time), with no business or assets except residential lots which it had been unable to sell, it is not surprising that the court refused to give much weight to these "reasons." This Court thought that *any* corporation formed to do business in the real estate field would have satisfied the *alleged* needs of American Pipe, and that the reasons advanced by the taxpayer did not overshadow the conclusion that the acquisition was for a huge potential tax benefit (tax losses of $400,393.91 acquired for a total stock cost of $11,248.96). It is perfectly evident from the facts that Lane knew all about the condition of Palos Verdes and the potential tax benefits and that Palos Verdes had no assets or business of real interest to American Pipe—its only asset was its potential tax loss. The situation in our case is quite different—the officers of Refiners knew nothing about the tax basis of the Hilo Gas assets until after the acquisition; they did not consider tax aspects until after the acquisition; Refiners had no prospective profits "looming large"; Refiners needed to acquire Hilo Gas to secure

a market for its butane; Hilo Gas was in the same general business as Refiners and the continuation of the gas business on the Island of Hawaii was of vital interest to Refiners. Refiners in the summer of 1950 was a brand-new business, with operating losses of its own and no possible need of another's operating loss.

The decision in *American Pipe,* 25 T.C. 351 (1955) makes it clear that Section 129 requires a determination of the subjective *intent* of the taxpayer and that intent must be to avoid or evade taxes. "Of course, the statute was not intended to upset bona fide transactions or acquisitions where the proscribed *intent* is not present." 25 T.C. at p. 365. The taxpayer must have *"the principal purpose or intent* underlying such acquisition of evading or avoiding" taxes. 25 T.C. at p. 366. "Although *intent* is a state of mind, it is none the less a fact to be found." 25 T.C. at p. 366. (Emphasis added.) In our case, the facts are that there was *no intent* whatever to evade or avoid taxes when Refiners purchased control of Hilo Gas. Rather, this was a bona fide business transaction which the statute was not intended to upset.

There is another significant difference between this case and *American Pipe:* Here we have a stipulation that at the time of the acquisition of the controlling stock "no consideration was given by Refiners to the tax aspects of the transaction". (Paragraph XVI, Stipulation of Facts, R. 41-42.) There was no such stipulation in *American Pipe* and the court found that major consideration was given to the tax aspects. If

no consideration was given to the tax aspects of the transaction, the tax avoidance *intent* required by *American Pipe* cannot possibly be found.

Because taxes were not considered, our case is also stronger for the taxpayer than the Section 129 cases referred to above, which found for the taxpayer despite the fact that taxes were considered. Our case is further enforced by the statement of the *seller* (Mr. Lyman) that no investigation was made of the losses of Hilo Gas or the book value of the assets and that the purpose of the purchase was to do away with the old manufactured gas plant and replace it with butane shipped by Refiners. There is no fact in the record which is inconsistent with the actual business purpose of the acquisition of control and no fact which is consistent with the alleged tax evasion purpose.

The District Judge found that the taxpayer has the burden of proof here to show that Section 129 is not applicable, citing a case to show that the burden of proof is on the taxpayer to show that *the Commissioner's* determination is invalid. (R. 89.) The Tax Court has also held that where *the Commissioner* has determined that the principal purpose of the acquisition was to gain a tax benefit, the burden of proof is on the taxpayer to show otherwise. *American Pipe, supra,* 25 T.C. 366; also *Elko Realty, supra.* That may be, but the Commissioner in this case did *not* determine that the principal purpose of the acquisition was tax evasion or avoidance. Section 129 was not cited or referred to as a reason for disallowing the loss carry forward. (Paragraph XXII, Stipulation of Facts, R.

46-48.) The defense of the applicability of Section 129 was first raised by the Department of Justice, not the Commissioner, in its brief in the court below. Under the circumstances, does not the burden of proof with respect to this defense rest on the Government rather than the taxpayer?

Whoever has the burden of proof, we submit that the stipulated facts here establish that the principal, indeed the only purpose, of the acquisition of Hilo Gas by Refiners was a business purpose, and that there is no evidence of any kind to support the District Judge's conclusion that the principal purpose was tax evasion or avoidance.

This being an appeal from a District Court, the provisions of Rule 52(a), Federal Rules of Civil Procedure, are applicable: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial Court to judge of the creditability of the witness." In a leading case, the Supreme Court has held that a finding is "clearly erroneous" when "although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States v. Gypsum Co.,* 333 U.S. 364, 395 (1948). In this case, we submit, there is no evidence at all to support the District Judge's findings of fact on this issue.

Where findings of fact are based on documentary evidence, such as depositions or stipulations of fact, this court and many others have held that the review-

ing court is in just as good a position as the trial court to judge creditability and the findings of fact are not binding on the appellate court and will be given slim weight on appeal. *Equitable Life Assur. Soc. v. Irelan,* 123 F.2d 462, 464 (9th Cir. 1941); *Stevenot v. Norberg,* 210 F.2d 615, 619 (9th Cir. 1954); *United States v. Fotopulos,* 180 F.2d 631, 638 (9th Cir. 1950); *Orvis v. Higgins,* 180 F.2d 537, 539 (2d Cir. 1950) (where the trial judge "decides a fact issue on written evidence alone, we are as able as he to determine creditability, and so we may disregard his finding"); 5 *Moore, Federal Practice* ¶52.04, at 2637 (2d ed. 1953). In *Elko Realty, supra,* Fox was a witness (the only one) and evidently his creditability did not impress the Tax Court; the Court of Appeals affirmed *per curiam* evidently being reluctant to disturb a finding based in large part on oral testimony of an "unclear" and "inconsistent" witness. The evidence in the present case is entirely a written stipulation of facts; there is no question of observing the creditability of witnesses; this court is in just as good a position as the trial court to make a finding of fact on the purpose of the acquisition of Hilo Gas by Refiners.

C. IF SECTION 129 IS NOT APPLICABLE, REFINERS AND HILO GAS CANNOT BE DENIED THE PRIVILEGE OF FILING CONSOLIDATED RETURNS UNDER SECTION 141.

Aside from Section 129, the District Court gives one other basis for its decision as follows: "Section 141 of the Code of 1939, which extends the privilege

of making consolidated returns to affiliated groups, may not be utilized to distort income by acquiring a 'loss corporation' for a nominal consideration, and then using such corporation's losses to avoid taxes." (R. 87.)

No authority is cited for this sweeping pronouncement. Certainly, there is nothing in the Internal Revenue Code (unless it be Section 129) which authorizes the Commissioner to deny to taxpayers the privilege of filing consolidated returns under Section 141. The statute itself prescribes no test or prerequisite to its applicability other than 95% stock ownership:

> "The statute invoked by Fox, section 141, Internal Revenue Code of 1939, authorizes the filing of consolidated returns by an affiliated group of corporations, where stock possessing at least 95 per cent of the voting power and of the non-voting stock of each is owned directly by one or more of the others. * * * The statute prescribes no test of affiliation other than stock ownership. Even if Fox's primary purpose was to reduce his own tax liabilities by offsetting the probable losses from the Post against the expected income from the dividends and gas leases through the means of a consolidated return, that is a legitimate purpose and the action is authorized by the statute." *John Fox,* 17 CCH Tax Ct. Mem. 1006, 1019 (1958).

The sole test of what is a member of an affiliated group is statutory and the only requirement is the requisite stock ownership. Section 141(d) and (e); *Burnet v. Aluminum Goods Co.,* 287 U.S. 544, 547-8

(1932); *Autosales Corp. v. Commissioner,* 43 F.2d 931, 933 (2d Cir. 1930); *Hancock Construction Co., et al.,* 11 B.T.A. 800, 804 (Acq. 1928).

It is quite obvious that Congress intended to give corporations which complied with the provisions of the law the privilege of filing consolidated returns and offsetting the losses of one member of the group against the profits of another member, even though this resulted in tax savings and to that extent "distorted income." It has been perfectly clear to Congress from the beginning that a large advantage of the consolidated return provisions was to permit a parent to offset its own gains against the losses of a subsidiary. Indeed, this was the principal reason the consolidated return privilege was eliminated in 1934 and not restored until 1942. 8 Mertens, *Law of Federal Income Taxation,* Section 46.02. In the report accompanying the 1934 Act the Ways and Means Committee of the House stated:

> "The subject of consolidated returns has long been in controversy. * * * It cannot be denied that the privilege of filing consolidated returns is of substantial benefit to the large groups of corporations in existence in this country. This is especially true in depression years, for the effect of the consolidated return is to allow the loss of one corporation to reduce the net income and tax of another, and during a depression more losses occur." H.R. Rep. No. 704, 73d Cong., 2d Sess., Seidman, *Legislative History of Federal Income Tax Laws 1938-1861,* 377 (1938).
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> "The principal tax advantage reflected in a consolidated return computation, one that has been

> affirmatively recognized in all Treasury regulations, is the rule pertaining to the computation of consolidated net income, the rule which permits the losses or expenses of one affiliate to be offset against the profits of another." V. J. Heffernan, "Points to Be Considered in the Filing of Consolidated Returns," 5 N.Y.U. *Institute on Federal Taxation* 283, 286.

Section 141 confers a *privilege* of filing consolidated returns. An extra 2% tax is imposed for exercising that privilege. (Section 141(c).) The Secretary of the Treasury is required to prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group may be determined in such manner as clearly to reflect income. (Section 141(b).) Under the Consolidated Return Regulations losses of a subsidiary realized *prior* to affiliation cannot be carried forward and used against the profits of a parent after affiliation. On the other hand, losses of a subsidiary realized *after* affiliation may be carried forward and used against the profits of a parent in another year of the consolidated return period. See Reg. 129, Section 24.31(a)(1), (2), (3), (5) and (6) and Section 24.31(b)(3). The only requirement is that the loss of the subsidiary must be realized *after* affiliation—not before. If there is any "distortion" of income when a taxpayer complies with these regulations and utilizes a post-affiliation loss of a subsidiary against income of the parent during the consolidated return period, it is a "distortion" knowingly provided for by Congress and by the Treasury's own regulations.

The Code does not say that a corporation is entitled to a deduction for "economic" losses sustained during the taxable year but that it may not deduct losses which are not "economic" losses. Section 23(f) (losses by corporations) refers merely to "losses sustained during the taxable year." In the case of sales of property a "loss", for tax purposes, is the excess of the basis (cost) of the property over the selling price. Sections 111(a) and 113(b), IRC 1939. In consolidated returns, the profits or losses for each affiliate are figured out for the taxable period and then combined to arrive at the consolidated net income or loss for the period. Reg. 129, Section 24.31(a). There is not a word in the Code or in the lengthy and complex Consolidated Return Regulations which requires that only "economic" losses may be considered in these computations. Furthermore, there is nothing in the Code or Regulations which says that a parent is not entitled to consolidate a subsidiary unless it paid more than a "nominal consideration" for the subsidiary's stock. The parent must own 95% of the stock—how it got it or what it paid for it is immaterial. (Section 141(d).)

Any such vague requirement as "economic loss" would be impossible of statutory or regulatory definition, impossible to apply, impossible to administer. The nearest thing to such a requirement is the "disproportionate purchase price" provision of Section 269(c) which takes a dozen lines of statutory language to spell out and is applicable only to acquisitions made after March 1, 1954. Section 269(c) has been criti-

cized as "filled with obscurity" and "likely to raise more questions than it will help solve." (7 Mertens, *supra,* Section 38.69. How much more unworkable would be an *unwritten* rule permitting the Commissioner to deny affiliation whenever there is "no economic loss" to the parent. If there were such a rule, it is safe to say no parent corporation would elect to file consolidated returns as the principal benefit resulting therefrom could be denied almost at the whim of the Commissioner.

It may be that Congress should have written some additional restriction into Section 141 to prevent a parent utilizing a post affiliation loss of a subsidiary in a consolidated return period in a case where the parent's cost of acquisition of the subsidiary is less than the amount of the loss. However, Congress has not done so and neither the Treasury nor the Courts may add to a tax statute something which is not there. See *Commissioner v. Acker,* ..... U.S. ..... 4 L ed 2d 127, 131 (1959); *United States v. Calamaro,* 354 U.S. 351, 359 (1957); *Koshland v. Helvering,* 298 U.S. 441, 447 (1936); *Reinecke v. Gardner,* 277 U.S. 239, 244 (1928); *Manhattan Co. v. Commissioner,* 297 U.S. 129, 134 (1936); *Smietanka v. First Trust & Savgs. Bank,* 275 U.S. 602, 606 (1922); *Commissioner of Internal Revenue v. Reece,* 233 F.2d 30, 33 (1st Cir. 1956).

The situation is even stronger here than in the usual case where the Code is silent and the Treasury attempts to fill the gap with a regulation. As noted above, Section 141(b) gives the Secretary express

power to prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations may be determined in such manner as to clearly reflect income. The Consolidated Return Regulations, promulgated pursuant to this provision, not only do not prevent the taxpayer from doing what was done here, they *require* the returns to be prepared and the income to be determined in this manner. Reg. 129, Section 24.31 provides that in the case of an affiliated group of corporations which makes a consolidated return, the tax liability *shall* be determined subject to the rules of computation set forth in paragraphs (a) and (b) of the section. Refiners and Hilo Gas admittedly complied with these regulations. That being the case, how can it be said that the resulting computation "distorts income," a conclusion apparently reached by the District Judge?

In the court below, the Government took the position in its brief that assuming Section 129 is not applicable, affiliation under Section 141 could be denied because the acquisition did not serve a business purpose, citing *J. D. & A. B. Spreckels Co.,* 41 B.T.A. 370 (1940). This is really no more than the Section 129 argument all over again—if there is no business purpose for the acquisition as distinct from a tax saving purpose, the principal purpose of the acquisition is tax avoidance or evasion and the benefits of consolidation can be denied under Section 129 or the *Spreckels* rule. On the other hand, if there is a legitimate business purpose for the acquisition, neither Section 129 nor the *Spreckels* rule is applicable. It

all turns on the factual question—was there a legitimate business purpose?

The *Spreckels* case, which arose before Section 129 was added to the Code, is another instance of corporate transactions undertaken without any business purpose at all, but solely for tax reasons. The Spreckels Company and the Spreckels Securities Company were owned by the same members of the Spreckels family in the same proportions. The Securities Company owned all the stock of the Savage Tire Company. Prior to 1927 the Tire Company sustained operating losses and in that year its manufacturing operations were discontinued, and until 1930 or 1931 it rented its plant to others. In 1931 the Securities Company considered the capital stock of the Tire Company to be worthless and wrote down its book investment in the stock to $1. In its separate Federal income tax return for 1931, the Securities Company claimed a loss in the amount of $9,175,149 on its investment in the stock of the Tire Company. On November 22, 1932, the Tire Company contracted to sell its plant to the Aztec Brewing Company for $50,000. On November 25th a down payment of $5,000 was made and an agreement was signed to sell and purchase the plant and to pay the balance of the purchase price over a period of time. It was intended that the Brewing Company would take possession of the Tire Company's plant at the end of 1932. On February 20, 1933, the Tire Company executed a deed conveying the plant to the Brewing Company. The deed was deposited in escrow to be delivered when the purchase

price was paid in full. Also on February 20, 1933, the Spreckels Company acquired all of the stock of the Tire Company from the Securities Company for $1. On April 5, 1933, the Brewing Company paid the remainder of the purchase price and received a deed to the plant. On the sale of its plant the Tire Company sustained a loss of $192,849. For the year 1933 the Spreckels Company filed a consolidated return, including the income of the Tire Company for the ten-month period beginning March 1, 1933. A deduction of $191,268 was taken in the consolidated return as the net loss sustained by the Tire Company during the last ten months of the taxable year on the sale of the plant. The Commissioner disallowed the deduction of the net loss of the Tire Company, primarily on the ground that the Tire Company was not a member of the affiliated group. The Board of Tax Appeals sustained the Commissioner.

In short, the Spreckels Company acquired from the Securities Company (same stockholders) for $1 all the stock of the insolvent Tire Company which was not engaged in any business and which had made a binding agreement to sell its assets at a loss of some $191,000. The Spreckels Company had a very substantial net income. There was no possible business reason for the transaction—no business reason was even urged by the taxpayer. The sole purpose of the transaction was to obtain the loss of the Tire Company for tax purposes. The Board of Tax Appeals found that there was no business purpose for the Spreckels Company to acquire the stock of the Tire

Company in February, 1933 and that therefore the affiliation could be denied by the Commissioner.

In *Spreckels* the Board of Tax Appeals referred to and distinguished *Bishop Trust Company, Limited,* 36 B.T.A. 1173 (1937)(A). Bishop Trust Company acquired all the stock of Waterhouse Trust Company at the time when the Waterhouse Company was in failing condition. The stock was acquired, *without cost* to Bishop Trust Company, for the purpose of preventing the failure of the Waterhouse Company, preventing loss on the part of clients of the Waterhouse Company, and acquiring new clients for Bishop Trust Company. The stock was acquired on February 14, 1931. On May 29, 1931 the manager of Bishop Trust Company informed the directors that the operation of the Waterhouse business was causing a monthly loss "as it is in the nature of a receivership." The Waterhouse Company was continued as a separate organization until it was merged into the Bishop Trust Company on December 30, 1933. Bishop Trust Company filed consolidated returns for 1931, 1932 and 1933 in which it took advantage of the Waterhouse losses against its own income. The Board held that the Commissioner's determination denying the affiliation and the privilege of filing consolidated returns was in error, stating:

> "There was no acquisition of a subsidiary for the sake of its prior net losses within the condemnation of the *Woolford Realty* decision. The clear implication of that decision is that the losses of one affiliate are available to offset tax-

able net income of another if sustained during the period of affiliation—which is the situation here. *Gregory v. Helvering,* 293 U.S. 465, is wholly inapplicable unless it is to be read as disapproving any construction of a statutory term like reorganization or affiliation which recognizes a lower tax. That case revealed a sham, and the Court disregarded the mask and dealt with realities; but, as in *Helvering v. Minnesota Tea Co.,* 296 U.S. 378, it can here be said, 'The present record discloses no such situation; nothing suggests other than a *bona fide* business move.'" (at p. 1180.)

Our case is like the *Bishop Trust Company* case and unlike the *Spreckels* case in that there was a *bona fide* business purpose for the acquisition of Hilo Gas and that the acquisition was made without thought of tax benefit. In the *Bishop Trust Company* case it was certain that a tax benefit would arise because the Waterhouse Trust Company was hopelessly insolvent and liquidation of its affairs could not be expected to prove profitable. Since the Bishop Trust Company was making a profit, the tax advantage of filing consolidated returns and using the loss of the Waterhouse Company for the three years, 1931, 1932 and 1933, was obvious. Nevertheless, because there was a bona fide business motive for the acquisition, affiliation was not denied. In the *Spreckels* case, on the other hand, there was no business purpose whatever in the Spreckels Company acquiring the stock of the Tire Company for $1. The sole purpose was a tax reducing purpose. The *Spreckels* decision dis-

tinguished *Bishop Trust* in the following language which could be applied almost verbatim to the present case:

> "In that case [*Bishop Trust*] the stock of the subsidiary was acquired as a '*bona fide* business move.' One of the purposes for the acquisition of the stock of the subsidiary was to enable the parent corporation to take over the business of the subsidiary." (at p. 377.)

David's Specialty Shops v. Johnson, 131 F. Supp. 458 (S.D.N.Y. 1955) is another case holding that where there was no business purpose for the affiliation other than tax reduction, the affiliation will be denied. The court held that groundless fear of liability on a bond was not a business purpose and that, anyway, affiliation was not necessary because plaintiff could have advanced the money to pay the debt, as in the past, without affiliating. The decision has been severely criticized by a leading tax textbook for substituting the court's judgment on "groundless fear" for that of the taxpayer. "It does not appear to be proper, however, when the sincerity of the reason advanced is admitted, for a court to substitute its judgment for that of the taxpayer as to the reasonableness of the admitted purpose. This is especially unfair since the court, if it substitutes its judgment, has the benefit of hindsight as well as an incomplete grasp of all the considerations which motivated the taxpayer in its decision." 8 Mertens, *supra,* Section 46.09. In any event, the decision is helpful to our case rather than otherwise because it

holds that where there is a business reason for the acquisition, the tax benefit from filing consolidated returns cannot be denied, even though the stock of the subsidiary had been donated to the parent and so cost it nothing: "* * * If plaintiff's affiliation with Holding Corp. served a purpose other than or in addition to that of tax reduction, plaintiff may take advantage of the tax benefit that accrued to it by reason of the affiliation. * * *" (at p. 460.)

In the court below the Government also relied on *Gregory v. Helvering,* 293 U.S. 465 (1935). This case held that a letter perfect "reorganization" could be disregarded for tax purposes because it had no business or corporate purpose but was a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character. The taxpayer created a temporary corporation (which lasted six days) to effect a tax saving in the distribution of corporate shares to herself by coming under the reorganization provisions. There was a preconceived plan not to reorganize a business but to transfer corporate stock to the taxpayer—the corporation was nothing more than a contrivance to this end; it was brought into existence for no other purpose; it performed and was intended to perform no other function; it was then immediately put to death. It was an elaborate and devious form of conveyance masquerading as a corporate reorganization and nothing else.

In the present situation there is no artifice or device created to accomplish a tax purpose. The pur-

chase of the stock of Hilo Gas and the sale of the utility assets to Honolulu Gas were not fictitious or sham transactions, or temporary devices for securing tax benefits. Hilo Gas was an established business of long standing. The business was continued by Refiners and Honolulu Gas after the acquisition of control by Refiners—indeed securing a continuance of the gas business on the Island of Hawaii was a purpose of the acquisition. The transactions were in fact no different from what they purported to be. The business reasons for Refiners' purchase of the Hilo Gas stock have been given. The business and regulatory reasons why Refiners rather than Honolulu Gas purchased the stock have been given. The reason for selling the utility assets to Honolulu Gas is obvious —Refiners was not a utility subject to the regulation of the Public Utilities Commission and did not want to become one. (Paragraph III, Stipulation of Facts, R. 27-28.) It is difficult to see how the holding of *Gregory v. Helvering,* 293 U.S. 465, has any pertinence here. As stated in the *Bishop Trust* case, *supra:*

> "*Gregory v. Helvering* is wholly inapplicable unless it is to be read as disapproving any construction of a statutory term like reorganization or affiliation which recognizes a lower tax." (at p. 1180.)

If there is a bona fide business purpose and the transaction is real and not a sham, it will stand up whether or not there was a tax savings—"distortion of income" in the Government's view. Perhaps the leading interpreter of the meaning of *Gregory v.*

Helvering, supra, is Judge Learned Hand, who wrote the opinion in the Circuit Court which was affirmed on appeal. In a later case, *Chisholm v. Commissioner,* 79 F.2d 14 (2d Cir. 1935) *cert. denied* 296 U.S. 641, Judge Hand made a celebrated pronouncement on *Gregory v. Helvering, supra.* Here two brothers had for six or eight months discussed forming a partnership to manage their properties (one wanted to get out of business); on September 26 they gave a thirty-day option to K to purchase their shares in H Co. at a profit to them; K agreed on October 11 to take up the option, which could only be done by paying cash before its expiration; their attorney then told the brothers they could postpone or escape taxes by forming a partnership and transferring the H shares to it; this was done on October 22; on October 24 K purchased the H shares from the partnership. The Commissioner urged that the brothers rather than the partnership should be taxed on the gain, relying on the fact that the firm was organized to escape taxation and citing *Gregory v. Helvering, supra.* The Court of Appeals held that since the firm was a bona fide organization engaged in the business of managing the brothers' properties, *Gregory v. Helvering, supra,* was not applicable despite the tax savings—"* * * a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it * * *. In *Gregory v. Helvering, supra,* the incorporators adopted the usual form for creating business corporations; but their intent, or purpose, was merely to draught the papers, in fact not to create corporations as the court understood

that word. That was the purpose which defeated their exemption, not the accompanying purpose to escape taxation; that purpose was legally neutral. Had they really meant to conduct a business by means of the two reorganized companies, they would have escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world." (at p. 15.) See also the perceptive discussion of the *Gregory* case in *Granite Trust Co. v. United States,* 238 F.2d 670, 677 (1st Cir. 1956); *Sun Properties v. United States,* 220 F.2d 171 (5th Cir. 1955); *The Diamond A. Cattle Co. v. Commissioner,* 233 F.2d 739 (10th Cir. 1956).

SECOND ISSUE: HAWAII INCOME TAXES ON CAPITAL GAINS REALIZED IN 1955 ARE DEDUCTIBLE.

FACTS

The stockholders of Refiners on November 25, 1955 adopted a plan of complete liquidation which provided for the sale of the refinery facilities to Standard, the sale of the remaining operating assets (Isle-Gas business and related assets) to Honolulu Gas and the liquidation and dissolution of the corporation. Pursuant to this plan, the refinery facilities were sold to Standard on December 6, 1955 and the Isle-Gas business and related assets were sold to Honolulu Gas on December 31, 1955. Thereafter, and within a period of twelve months from the date of adoption of the plan of liquidation, the affairs of the corporation were wound up, all of the assets of the corporation were distributed in complete liquidation, less assets retained to meet

claims, and the corporation was dissolved by order of the Treasurer of the Territory of Hawaii on November 19, 1956. No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas as aforesaid, pursuant to the provisions of Section 337, Internal Revenue Code of 1954. (Paragraph XXVII, Stipulation of Facts, R. 49-50.)

The Territory of Hawaii net income tax law which was applicable in 1955 did not have any non-recognition provision similar to Section 337 of the Federal Code.[8] Consequently, a portion of Refiners' 1955 Hawaii net income tax was allocable to the gain from the sale of the refinery facilities to Standard and the gain from the sale of the Isle-Gas business and related assets to Honolulu Gas. The Commissioner allocated $61,061.59 of the 1955 Hawaii net income tax to these gains and disallowed the deduction of this amount for Federal income tax purposes. The reason given for the disallowance is that Section 265 of the Internal Revenue Code of 1954 "prohibits the deduction of expenses allocable to income exempt from federal income tax." (Paragraph XXIX, Stipulation of Facts, R. 50-51.)

[8]The Hawaii Income Tax Law of 1957, which makes the Federal Internal Revenue Code generally applicable, now incorporates such a non-recognition provision.

ARGUMENT.

A. SECTION 265 ("EXPENSES AND INTEREST RELATING TO TAX EXEMPT INCOME") IS NOT APPLICABLE BECAUSE NON-RECOGNIZED GAINS UNDER SECTION 337 ARE NOT INCOME "WHOLLY EXEMPT" FROM THE INCOME TAX.

Section 337(a)[9] is a new section of the Code added in 1954 to eliminate double taxation in certain corporate liquidations, as follows:

> "SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.
>
> "(a) *General Rule.* —If—
>
> "(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and
>
> "(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,
>
> then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

Section 164(a) provides that, except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year. There is no exception for State or Territorial income taxes. Consequently, Refiners is admittedly entitled to a deduction for Hawaii taxes paid or accrued for the year 1955, unless some other section of the law prohibits it. The Commissioner contends that

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[9]References in this section of the brief, unless otherwise noted, are to sections of the Internal Revenue Code of 1954.

Section 265 prevents the deduction of Hawaii income taxes allocable to the gain from the sale of Refiners' assets pursuant to its plan of liquidation.

Section 265 is as follows:

> "SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.
>
> "(1) *Expenses.* —Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) *wholly exempt from the taxes imposed by this subtitle*, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.
>
> "(2) *Interest.*—Interest on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from the taxes imposed by this subtitle." (Emphasis added.)

Capital gains not recognized because of the provisions of Section 337 of the Internal Revenue Code do not constitute income "wholly exempt" from taxes within the meaning of Section 265(1). Consequently, Section 265(1) is not applicable in this situation and the total Hawaii income tax for 1955 should have been allowed as a deduction by the Commissioner.

The Internal Revenue Code has consistently made a distinction between *exempt income* and *non-recognized gains.* In the 1939 Code many of the exempt items were contained in Section 22(b) which commenced: "(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:". In contrast the non-recognition provisions, many of which were collected in Section 112(b), merely provided for non-recognition of gain or loss, and did not state that the gain should not be included in gross income or should be exempt from taxation. Section 112 was entitled *"Recognition of Gain or Loss."* Section 112(a) provided:

> "(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

Section 112(b) (1) is typical:

> "(b) *Exchanges Solely in Kind.* —
>
> "(1) *Property Held for Productive Use or Investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment * * * is exchanged * * *."

The distinction is carried over to the 1954 Code. Part III of Subchapter B of Subtitle A is entitled: "ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME," and lists numerous items with the introductory phrase, "gross income does not include."

See Sections 101 to 120, inclusive. Section 121, "*Cross References to Others Acts*", states:

"(a) For *exemption* of—

"(1) Adjustments of indebtedness under wage earners' plans, see section 679 of the Bankruptcy Act * * *." etc. (Emphasis added.)

It is clear that all of the items in Part III, Sections 101-121, inclusive, are intended to be treated as *exemptions*. The non-recognition provisions, on the other hand, state merely that "no gain or loss shall be recognized," with no reference to exemption or to exclusion from gross income. See for example, Sections 332, 337, 351, 354, 361, 1031, 1032 and 1033.[10]

There is a reason for the distinction. In the case of exempt income, the income is permanently exempt; it will never be taxed. In the non-recognition situation the gain in question is simply not taxed in the particular transaction that qualifies for non-recognition treatment; it may be taxed if the transaction fails to meet the non-recognition requirements or it may be taxed

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[10]The distinction between exemption and non-recognition is pointed out in a law review article which supports our position on this issue. Charles MacLean, Jr., "Taxation of Sales of Corporate Assets in the Course of Liquidation," 56 *Colum. L. Rev.* 641 (May, 1956) states:

"In computing a liquidating corporation's taxable income, a Treasury agent has reportedly taken the position that Sec. 265 operates to deny deductions for state income taxes paid on gains that are not recognized under Sec. 337. This interpretation of Sec. 265 seems wrong since the statute disallows only deductions that are allocable to income 'wholly exempt' from federal income taxes. In cases involving specific classes of income, the Internal Revenue Code appears to distinguish between exemption and non-recognition." (at p. 672, footnote 92.)

at another time. In short, it is not "wholly exempt" from the income tax.

In adopting Section 337 Congress was well aware of these two long standing contrasting statutory provisions, one providing that gain is "not recognized" and the other providing that gain or income is "not included in gross income" or is "exempt" from tax. In using the "not recognized" phrase in expressing the purpose of Section 337 Congress has answered the present question in favor of Refiners because Section 265, as it has for many years, applies to income "wholly exempt" from tax and not to gains "not recognized." But, beyond this, a consideration of the purpose and requirements of Section 337 will demonstrate that the phraseology chosen by Congress in that section is accurate, because the philosophy of Section 337 is not only similar to that of the other "non-recognition" provisions but is also completely contrary to that of the "exemption" sections.

Section 337 was adopted to eliminate the *double* taxation which occurs when a corporation sells its assets at a profit and then liquidates, there then being one tax on the corporation and another on the stockholders who surrender their stock for assets in a taxable liquidation. See *Commissioner v. Court Holding Co.,* 324 U.S. 331 (1945). Section 337 does not apply unless at least *one* tax (that on the stockholders) is incurred within a year of the adoption of the plan of liquidation. This is clear from the law itself since Section 337(c)(1)(B) and (2) deny the use of the section where the liquidation is tax free to the stock-

holders either under Section 332 or 333. This is also made abundantly clear by the legislative history of Section 337. Congress was willing to provide that the gain on the sale of assets by the corporation would not be recognized to the corporation provided the corporation promptly sold its assets and distributed the proceeds to the stockholders who would then have to pay a tax on the gain and the Treasury could realize its revenues promptly.[11]

The following extracts from the House and Senate Committee Reports disclose the purpose of Section 337 and the explicit understanding of Congress that the gain not recognized to the Corporation is promptly taxed to the stockholders.

> "(3) *Court Holding Company.*—Your committee's bill eliminates questions arising as a result of the necessity of determining whether a corporation in process of liquidating made a sale of assets or whether the shareholder receiving the assets made the sale. Compare *Commissioner v. Court Holding Company* (324 U.S. 331), with *U. S. v. Cumberland Public Service Company*

[11] A leading Law Review comment on Section 337 states:

> "The new provision contains certain limitations consistent with its purpose. Already mentioned is the requirement that the assets be sold within a period of twelve months after adoption of a plan of liquidation. While objections have already been made to the stringency of this requirement, it appears to be realistic and will give the taxpayer only one year in which to choose (by conforming or not conforming to all the requirements of section 337) recognition or non-recognition for gains or losses from sales. A longer period might be unfair to the revenues and difficult to police." Cohen, Gelberg, Surrey, Tarleau and Warren, "Corporate Liquidations under the Internal Revenue Code of 1954," 55 *Colum. L. Rev.* 37, p. 45 (January 1955).

(338 U.S. 451). This last decision indicates that if the distributee actually makes the sale after receipt of the property then there will be no tax on the sale at the corporate level. In order to eliminate questions resulting only from formalities, *your committee has provided that if a corporation in process of liquidation sells assets there will be no tax at the corporate level, but any gain realized will be taxed to the distributee-shareholder, as ordinary income or capital gain depending on the character of the asset sold.*" (Emphasis added.) H. Rep. 1337, 83d Cong., 2d Sess., 1954, pp. 38-39.

"Section 333 [337 in Senate bill] incorporates in the bill rules for treatment of the problem raised in the decisions of *Commissioner v. Court Holding Company* (324 U.S. 331) and *U.S. v. Cumberland Public Service Co.* (338 U.S. 341) and the numerous related cases. These decisions concern the question of whether the corporation or a shareholder effected a sale of property in connection with a liquidation. Under the decision in the *Cumberland Public Service Co.* case, supra, it is indicated that in the case of an actual distribution in liquidation of the corporation prior to an actual sale by the shareholders a single tax is imposed at the shareholder level. Accordingly, under present law, the tax consequences arising from sales made in the course of liquidation depend primarily upon the formal manner in which transactions are arranged. *The possibility that double taxation may occur in such cases results in causing the problem to be a trap for the unwary.*

"Your committee intends in section 333 to provide a definitive rule which will eliminate any uncertainty.

* * *

"*Subsection (a) accordingly permits the imposition of a single tax at the shareholder level upon property sold during the course of a liquidation* irrespective of whether the corporation or the shareholder in fact effected the sale provided the other provisions of this subsection are met. * * *" (Emphasis added.) H. Rep. 1337, 83d Cong., 2d Sess., 1954, pp. A106-107.

"(c) *Court Holding Company.*—Your committee follows the House bill in eliminating questions arising as a result of the necessity of determining whether a corporation in process of complete liquidation made a sale of assets or whether the shareholder receiving the assets made the sale. Compare *Commissioner v. Court Holding Company* (324 U.S. 331) with *U. S. v. Cumberland Public Service Company* (338 U.S. 451). This last decision holds that if the distributee actually makes the sale after receipt of the property, there will be no corporate tax on the sale. The result of these two decisions is that undue weight is accorded the formalities of the transaction and they, therefore, represent merely a trap for the unwary." S. Rep. 1622, 83d Cong., 2d Sess., 1954, pp. 48-49.

* * *

"Section 337 corresponds in function to section 333 of the House bill and concerns the problems raised by the decisions in *Commissioner v. Court Holding Company,* 324 U.S. 415, and *U. S. v. Cumberland Public Service Co.,* 338 U.S. 341, and the numerous related cases. These decisions involve the question of whether the corporation or the shareholder effected a sale of property in connection with the liquidation of the corporation. Under the decision in *Cumberland Public Service*

Co., supra, it is indicated that in the case of a distribution of property in liquidation of a corporation followed by its sale made in fact by its shareholders, a single tax is imposed at the shareholder level. *Where the shareholders in fact did not effect the sale, tax is imposed both at the corporate and at the shareholder level.* Accordingly, under present law the tax consequences arising from sales made in the course of liquidations may depend primarily upon the formal manner in which the transactions are arranged. Your committee intends in section 337 to provide a definitive rule which will eliminate the present uncertainties * * *." (Emphasis added.) S. Rep. 1622, 83d Cong., 2d Sess., 1954, p. 258.

There is a similar comment in the authoritative Law Review article above referred to:

"Section 337 of the new Code provides that if a corporation distributes all of its property (except assets retained to meet claims) in complete liquidation within twelve months after adoption of a plan of liquidation, no gain or loss will be recognized on sales or exchanges of property by the corporation during that twelve-month period. *This provision is designed to mitigate the impact of the dual system of corporate income taxation—a tax at the corporate level on corporate earnings followed by a tax at the shareholder level on distributions*—where the corporation, and therefore the basis for the dual tax, ceases to exist. * * *" Cohen, Gelberg, Surrey, Tarleau and Warren, "Corporate Liquidations under the Internal Revenue Code of 1954," 55 *Colum. L. Rev.* 37, p. 44 (January 1955).

Thus, Section 337 is intended to, and does no more than, eliminate double taxation of the income realized on sale of assets by a liquidating corporation—the tax at the corporate level is eliminated but the tax at the shareholder level is retained. In the language of the House Committee Report, *supra,* "if a corporation in the process of liquidation sells assets there will be no tax at the corporate level, but any gain realized will be taxed to the distributee-shareholder." For this reason Congress used the "not recognized" phrase in Section 337, rather than choosing the equally well known contrasting phrase that the gain "shall not be included in gross income" or shall be "exempt" from tax.

The gain here involved was of the nature which Congress wanted to tax. To "exempt" it from tax would be farthest from its mind. But its purpose was to provide for it being taxed once rather than twice. How natural then, to provide that such gain would not be "recognized" at the corporate level if it were immediately taxed at the shareholder level!

Further, the accuracy of the choice of the "not recognized" phrase by Congress, and the soundness of the ensuing result that Section 265 would not apply to such gain, are evident in a consideration of the results which would follow if the single tax result were obtained not by using Section 337 but by following the pattern approved by the Supreme Court in the *Cumberland Public Service Company* (338 U.S. 451 (1950)) case, cited in the foregoing Committee Reports, under which the corporation first liquidates

and then its stockholders sell the assets to the eventual purchaser. It is well settled that a corporation "realizes" no gain on the distribution of appreciated assets in such a complete liquidation. It is equally well settled, however, that the expenses as well as any taxes imposed on the corporation in making such distribution in liquidation are deductible without limitation. *Commissioner v. Wayne Coal Mining Co.,* 209 F.2d 152 (3rd Cir. 1954) (attorneys' and accountants' fees); *United States v. Arcade Co.,* 203 F.2d 230, 235-236 (6th Cir. 1953) (attorneys' and accountants' fees); *Pacific Coast Biscuit Co.,* 32 B.T.A. 39, 42-43 (1935) (A. 1954-1 *Cum. Bull.* 6) (attorneys' fees and depositary service fees); *Tobacco Products Export Corp.,* 18 T. C. 1100 (1952) (N.A. 1955-2 *Cum. Bull.* 11) (actually involving both New York transfer tax and Federal stamp tax on the transfer of assets in liquidation).

Although under such circumstances the gain to the distributing corporation on the appreciation of the assets distributed is not "realized", it is clearly established that the expenses and taxes relating thereto are deductible. Certainly there is nothing to indicate that Congress in granting the relief from double taxation provided in Section 337 intended to attach a penalty consisting of the denial of deductions relating to the sale which deductions were allowed if the *Cumberland Public Service* route were used. In fact, the Committee Reports above quoted indicate exactly the opposite—that Congress intended to permit a taxpayer to achieve the same result that could be achieved under the *Cumberland Public Service* route by fol-

lowing the more simple procedure of having the corporation make the sale followed by the liquidation. Congress enacted Section 337 to eliminate the artificial distinction between the two types of liquidation procedure and to remove a tax trap for the unwary. It is submitted, therefore, that a comparison of the tax results under Section 337, contrasted with those under the alternative *Cumberland Public Service* route, again demonstrates that the choice of the "not recognized" language by Congress is accurate and that the resulting non-applicability of Section 265 is in harmony with the law and congressional intent in this field.

Although no case has as yet been decided involving the application of Section 265(1) to a Section 337 liquidation, the case of *Cotton States Fertilizer Co.,* 28 T.C. 1169, decided by the Tax Court on September 16, 1957, is a case directly in point upon the question of whether "gain not recognized" constitutes income "wholly exempt" from taxation within the meaning of Section 265. The Commissioner has acquiesced in this decision. 1958-1 *Cum. Bull.* 4. This case involved the inter-relation of Section 112(b), Internal Revenue Code of 1939 (Section 1033, I.R.C. 1954) and Section 24(a)(5), Internal Revenue Code of 1939 (Section 265(1), I.R.C. 1954). The former section provides that no gain shall be *recognized* if property is involuntarily converted into other property. Two of the taxpayer's plants were destroyed by fire. The taxpayer carried fire insurance but in order to present its claims for insurance it employed architects to recreate plans and specifications and a contractor to estimate

the replacement cost of the destroyed plants. As a result of such claims the taxpayer recovered insurance proceeds exceeding its cost basis for the destroyed plants. The proceeds were used to replace the destroyed property and no gain was reported in accordance with Section 112(f). The taxpayer deducted the amounts paid the architects and contractor as business expenses but the Commissioner disallowed the deductions under Section 24(a)(5). The Tax Court held the insurance proceeds on which gain was not recognized under Section 112(f) were not income "wholly exempt" from taxation by reason of the taxpayer's election under the non-recognition provision. The Court stated:

> "Sections 22(b) and 116 list a great number of items which, according to these sections of the statute, 'shall not be included in gross income, and shall be exempt from taxation under this chapter.' Nowhere in these sections are proceeds from fire insurance listed as being exempt." (at p. 1172.)

Similarly, in our case, nowhere in the Code is a gain realized in a Section 337 liquidation listed as being exempt.

The legislative history of Section 24(a)(5) (predecessor to Section 265), which was added to the Code in 1934, shows that the situation which Congress intended to cover is the usual case of exempt income which is never taxed. Note the examples given of exempt income in H. Rep. No. 704, 73d Cong., 2d Sess., p. 23:

> "Section 24(a)(5). Disallowance of deductions attributable to tax-exempt income: This

paragraph has been added to the bill to eliminate as deductions from gross income expenses allocable to the production of income wholly exempt from the income tax. Under the present law *interest on State securities, salaries received by State employees, and income from leases of State school lands* are exempt from Federal income tax, but expenses incurred in the production of such income are allowed as deductions from gross income." (Emphasis added.) Seidman's *Legislative History of Federal Income Tax Laws, 1938-1861,* p. 315.

The types of income referred to in the Committee Report are the ordinary classes of income wholly exempt from tax—not non-recognized gains. Similarly, the cases have applied Section 265(1) only to the usual types of specifically exempt income. See cases referred to in 4 Mertens *Law of Federal Income Taxation* § 25.128; 60-2 CCH, *Federal Tax Reporter* ¶2226. The one case where non-recognized gain, rather than a class of specifically exempt income, was involved is *Cotton States Fertilizer Co., supra,* holding that non-recognized gains are not "wholly exempt income." Cases there cited by the Commissioner were distinguished on the ground that "they involve only life insurance proceeds which are made wholly exempt by statute."

B. SECTION 265 IS NOT APPLICABLE BECAUSE IT DISALLOWS DEDUCTIONS FOR EXPENSES BUT DOES NOT REACH ITEMS DEDUCTIBLE AS TAXES.

The deduction sought by Refiners here is not for any *expense* incurred in producing the gain on sale

of assets, but for the Hawaii net income tax assessed on account of the gain. We submit that this tax is not an expense allocable to tax exempt income within the scope of Section 265.

The heading of Section 265 is "*Expenses and Interest Relating to Tax Exempt Income.*" The subheadings are:

"(1) *Expenses.*—

"(2) *Interest.*—"

Such headings were not included in the 1939 Code (See Section 24(a)(5)), but their use in the 1954 Code indicates the intention of Congress—that is, Congress intended to disallow expenses of producing tax exempt income and interest on indebtedness incurred to purchase or carry tax exempt bonds.

The headings and subheadings used in Section 265 are entirely consistent with the intent of Congress in enacting Section 24(a)(5) in 1934:

> "* * * This paragraph has been added to the bill to eliminate as deductions from gross income *expenses* allocable to the *production* of income wholly exempt from the income tax. * * *" (Emphasis added.) H. Rep. 704, 73d Cong., 2d Sess., Seidman's *Legislative History of Federal Income Tax Laws 1938-1861,* at p. 315.

The Senate Finance Committee Report notes that "it is contended that under the existing law all *expenses incurred in the production of such income* are allowable as deductions" and that the House bill specifically disallows *expenses* of this character, and the

Senate Report recommends that there be no denial of deductions for "*expenditures* incurred in earning tax-exempt interest." (Emphasis added.) S. Rep. 558, 73d Cong., 2d Sess., *Seidman, supra,* at p. 315.

In the case of sale of assets by a liquidating corporation, necessary expenses of negotiating and concluding the sale, such as brokers' commissions, property descriptions, surveys and legal fees would be considered as expenses incurred in the *production* of the gain. However, an income tax on the profit derived from the sale can have no part in the *production* of the gain.

Important distinctions exist between the basic concepts of the deduction for expenses and the deduction for taxes. First, the deduction for expenses is essential to arrive at the net amount of income from a business or other income producing activity. Taxes, on the other hand, are a charge on the net result of that activity and, strictly speaking, need not be deducted in arriving at net income. Secondly, referring to the language quoted above from the Committee Reports, taxes are neither "incurred in" nor "allocable to" the "production of income."

The deduction for taxes in general enjoys a much wider scope than the deduction for expenses. Expenses may be deducted only where they are connected with a trade or business or with the production of non-business income. Sections 162 and 212. But a broad variety of taxes, which are connected neither with business activity nor with the production of income, are allowable as deductions. Section 164. These include

many sales taxes, real estate taxes, personal property taxes, etc. Section 265(1) provides a sensible caveat to the general rule on deduction of expenses but, applied to taxes, it would be irrational. If taxes related to non-taxable income are to be denied deduction, so too should taxes which are in no way related to the production of income.

An item may be deductible as a tax, it may be deductible as an expense, or it may be deductible as either. While the terms are not mutually exclusive, neither are they equivalent, and the fact that an item may be denied deductibility as an expense does not affect its deductibility as a tax. Any tax deductible under Section 164 is absolutely deductible regardless of the nature of the tax and regardless of the circumstances of its application. Thus:

(a) Fees payable by a corporation in connection with the issuance of its capital stock are nondeductible because they are considered as capital items. But if the exaction in question is not a fee but is a tax imposed upon such issuance, then it is deductible. *Holeproof Hosiery Co.,* 11 B.T.A. 547 (1928); *Borg & Beck Co.,* 24 B.T.A. 995 (1931) (A. XI-1 *Cum. Bull.* 2); *Logan-Gregg Hardware Co.,* 2 B.T.A. 647 (1925); *Commercial Investment Trust Corporation,* 28 B.T.A. 143 (1933), *aff'd* 74 F.2d 1015 (2d Cir. 1935).

(b) Prior to the Revenue Act of 1942, which severely limited the deduction for Federal stamp taxes, the Commissioner himself held that a Federal stamp tax imposed upon a sale of securities at a loss was fully deductible as a tax although under the statute, the loss itself was not deduct-

ible. G.C.M. 18245, 1937-1 *Cum. Bull.* 70. However, if the exaction in question under such circumstances was a fee rather than a tax, the deduction was not allowed. I.T. 3161, 1938-1 *Cum. Bull.* 116.

(c) If a contractor, in acquiring material for a building, pays a use tax imposed directly on him, and with respect to certain other material a sales tax is "passed on" to him by his vendors upon whom the sales tax is directly imposed, the latter must be capitalized, whereas the former can be deducted. *Joe W. Stout,* 31 T. C. 1199 (No. 124) (March 25, 1959) (A. I.R.B. 1959-48, p. 6).

The foregoing cases illustrate the difference between taxes, which are an absolute deduction irrespective of whether they relate to a capital transaction, and other expenses which are not deductible if incurred in a capital transaction. If taxes cannot be deducted as expenses because of the rule that expenses in a capital transaction are a charge against proceeds or because of Section 265, they may nevertheless be deducted simply as taxes.

Actually, Section 265 can never apply to expenses which are allocable to income from the sale of assets. Such expenses *qua* expenses are not "otherwise allowable as a deduction," as required by Section 265. As expenses, they are allowable only as offsets against the sale proceeds, not as a deduction from gross income. If no tax is imposed on the gain realized on the sale, the qualification of an item as an expense of sale does not produce any tax benefit. It simply reduces gain which is not subject to tax in the first

place. State taxes on the other hand are not applicable to reduce gain but are an absolute independent deduction under Section 164 (taxes).

In view of the well established difference between taxes, which are an absolute deduction, and other expenses, which are not deductible in capital transactions, Congress can hardly have been contemplating taxes when it enacted the predecessor of Section 265.

In the case of State income taxes, the argument is even stronger since such taxes are not available as offsets against gain on the sale of assets to begin with. According to the Committee Reports quoted above, Section 265 is designed to apply to "expenses incurred in the production of [tax exempt] income." State income taxes on the gain realized on a sale of assets can hardly be viewed as incurred in the production of such gain.

We recognize that the Tax Court has in five cases denied deductions for taxes under Section 265(1): *Mary A. Marsman,* 18 T. C. 1 (1952); *George W. P. Heffelfinger,* 5 T. C. 985 (1945); *James F. Curtis,* 3 T. C. 648 (1944); *Henry P. Keith,* T. C. Memo. 10883, 1 CCH Tax Ct. Mem. 184 (1942), *aff'd* on another issue, 139 F.2d 596 (2d Cir. 1944); and *Laurence B. Halleran,* B.T.A. Memo. 106736, 106737 (1942), 1942 P-H *B.T.A. Mem. Dec.* ¶42,456, remanded on another issue by 2d Cir. However, the argument made above was never presented to the Tax Court in the *Marsman, Heffelfinger, Keith* and *Curtis* cases. The point was made and rejected on very brief consideration in the memorandum decision in *Halleran,* but it has never

been passed on by a higher court. We believe that the Tax Court has repeatedly misinterpreted Section 265 by including taxes within its scope. We urge this Court, on full and original consideration of this matter, to correct this misinterpretation and properly delineate the scope of Section 265. Section 265 was intended to and does relate to expenses incurred in the production of tax exempt income; State income taxes are not such expenses.

CONCLUSION

Refiners was entitled to the tax deductions claimed by it in the years 1953 and 1955 for the Hilo Gas operating loss and Hawaii income taxes. On the first issue, the decision of the District Court ignores the facts; on both issues the decision of the District Court misinterprets the law. For the reasons set forth above, it is respectfully submitted that the judgment of the District Court should be reversed with respect to both of these issues.

Dated, Honolulu, Hawaii,
July 25, 1960.

Respectfully submitted,

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Of Counsel.

No. 16,859

IN THE

United States Court of Appeals

For the Ninth Circuit

HAWAIIAN TRUST COMPANY, LIMITED, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, *Appellant*

vs.

UNITED STATES OF AMERICA, *Appellee*

On Appeal from the United States District Court for the District of Hawaii

BRIEF FOR THE APPELLEE

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BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion of the District Court (R. 71-96) is reported at 178 F. Supp. 637.

JURISDICTION

This appeal involves federal income taxes of $58,472.39 for the year 1953 (R. 49) and $51,468.20 for the year 1955 (R. 51). The 1953 taxes were paid on June 4, 1957 (R. 48), and a claim for refund therefor

was filed on August 28, 1957, and was rejected on October 23, 1957 (R. 49). The 1955 taxes were paid as follows: $35,670.31 on June 4, 1957; $1,560.73 on July 26, 1957; and the balance of $18,088.13 by credit on July 23, 1957. (R. 51.) Claim for refund therefor was filed August 28, 1957, and was rejected on October 23, 1957. (R. 51-52.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954 and on January 28, 1958, the suit for recovery of the taxes paid was brought in the District Court. (R. 3-19.) Jurisdiction was conferred on the District Court by 28 U. S. C., Sections 1340 and 1346. The judgment was entered on February 26, 1960. (R. 100-101.) Within sixty days and on March 11, 1960, a notice of appeal was filed. (R. 101.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

QUESTIONS PRESENTED

1. Whether the District Court erred in holding that a corporation acquiring the stock of another corporation in financial difficulties and thereupon causing all of the assets of the acquired corporation to be sold at a price approximating the cost of the stock, which was substantially less than the cost basis of the stock on the books of the acquired corporation, was not entitled to apply the difference as a loss against its own earnings by filing a consolidated return for itself and the acquired corporation.

2. Whether the District Court erred in holding that the taxpayer could not deduct Territory of Hawaii in-

come taxes allocable to gains from sales in liquidation of the taxpayer, not taxable to the taxpayer.

STATUTES AND REGULATIONS INVOLVED

The provisions of the relevant statutes and Regulations are set forth in the Appendix, *infra.*

STATEMENT

The facts as stipulated (R. 25-68) and found by the District Court (R. 74-84, 96) can be summarized as follows:

The first issue in this has to do with the taxpayer's claim of a deductible carry-forward loss in connection with a consolidated return. The parties principally involved are Pacific Refiners, Limited, hereafter referred to as the taxpayer or Refiners; Honolulu Gas Company, Limited, hereafter referred to has Honolulu Gas; and Hilo Gas Company, Limited, hereafter referred to as Hilo Gas. The appellant, Hawaiian Trust Company, Limited, is involved as trustee for the creditors and stockholders of the taxpayer, which was dissolved on November 19, 1956. (R. 25.) The taxpayer was organized on May 31, 1949, as a Hawaiian corporation. (R. 25.) Its principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in Hawaii. The taxpayer was not a public utility and none of its business was regulated by the Public Utilities Commission of Hawaii. (R. 27-28.) The taxpayer

secured its supply of petroleum products by contract with Standard Oil Company of California under which it was obligated to make a substantial minimum purchase each year. Standard supplied the taxpayer a mixture of heavy gas oil and butane; the taxpayer separated the butane from the gas oil at its refinery in Honolulu and sold the refined products. (R. 28.)

The taxpayer's original capital stock consisting of 250,000 shares of $1 par value common stock was purchased at issuance by Honolulu Gas and distributed as a dividend to the stockholders of Honolulu Gas. Honolulu Gas is a Hawaii public utility corporation operating a manufactured gas business in Oahu and purchasing its gas from the taxpayer. Later, in May of 1950, the taxpayer issued and sold to the public an additional 500,000 shares of common stock through a rights offering. Again, in April of 1951, the taxpayer sold an additional 750,000 shares of common stock to the public through a rights offering. (R. 25-26, 27.)

Hilo Gas was organized as a Hawaiian corporation in 1927. It engaged in the business of manufacturing gas from oil and distributing it through gas mains in the City of Hilo. (R. 29.) It also had a non-utility business—the distribution of bottled liquefied petroleum gas (called "Rock Gas") to rural customers beyond the city mains. (R. 32.) In 1948 and 1949 Hilo lost money and was in financial difficulty. (R. 29.) It appears that Hilo's gas manufacturing plant was obsolete and its production costs were high. (R. 53-54.) In the spring of 1950, Mr. Orlando Lyman, the president and the largest stockholder of Hilo Gas, approached

Mr. Englebright, the general manager of the taxpayer, for assistance in solving the problems of Hilo Gas. Hilo Gas proposed that it give up its manufacture of gas from oil and instead buy butane from the taxpayer, which Hilo Gas would then distribute through its gas mains in the City of Hilo, as a public utility. This would reduce its costs and enable it to compete with electric rates. (R. 29-30.) The taxpayer first made a survey and determined that Hilo's gas mains were in adequate condition to serve as a distribution system, and then offered to supply Hilo Gas with butane. Hilo Gas, however, also wished to secure the franchise for the distribution of the taxpayer's bottled butane for use by rural customers throughout the Island of Hawaii. The taxpayer rejected this proposal and refused to guarantee that its bottled gas (sold under the name of "Isle Gas") would not be in competition with Hilo Gas. (R. 30-31.)

About the middle of September, 1950, when these negotiations fell through, Mr. Lyman offered to sell his shares of Hilo Gas to the taxpayer or to Honolulu Gas. (R. 31.) The executive committee of the taxpayer met on September 16, 1950, to consider this proposal and were advised by Mr. Englebright that the Lyman shares and those of another stockholder could be purchased in a total that would exceed the 75 percent required to liquidate the corporation. (R. 31-32.) Mr. Englebright also reported that the purchase of the Hilo Gas stock was advantageous to the taxpayer to provide it an assured outlet for butane which was highly desirable, if not necessary, in view of the taxpayer's

purchase obligations with Standard Oil. Moreover, unless an attempt was made to perpetuate Hilo Gas, it would probably be dissolved, particularly since certain of its stockholders were interested in the Hilo Electric Company, which would serve as an obstacle to the expanding gas sales not only in Hilo but also in other parts of the Island. (R. 32-33.) Another meeting of the taxpayer's executive committee was held on September 26, 1950, at which the Hilo Gas situation was discussed. (R. 33.) On September 27, 1950, the board of directors of Honolulu Gas authorized the acquisition of the assets of Hilo Gas at a price not to exceed $75,000, subject to the approval of the Public Utilities Commission. (R. 33.)

On October 3, 1950, the taxpayer secured options to purchase 84 percent of all of the stock of Hilo Gas and on October 5, 1950, its board of directors authorized the purchase of all of the stock of Hilo Gas. (R. 33-34.) Eighty-four percent of the stock of Hilo Gas was sold to Refiners on October 6, 1950, and by October 25, 1950, the taxpayer had acquired 96 percent of the stock of Hilo Gas—all but 164 shares. (R. 35.) The total cost to the taxpayer of the Hilo Gas stock purchased by it was $63,897.20. (R. 35-36.)

The original plan of the new controlling stockholder of Hilo Gas (the taxpayer) had been to sell the utility assets to Honolulu Gas, to sell the remaining assets to itself, and to dissolve the corporation at such time as its directors determined in their discretion to be convenient. (R. 43.) At the time of the acquisition of the stock on October 6, 1950, no consideration was given by

the taxpayer to the tax aspects of the transaction. The taxpayer's officials did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to the taxpayer until after the decision had been made to purchase the stock. Mr. Lyman of Hilo Gas stated that, so far as he knew, no investigation was made into the accumulated loss of Hilo Gas, nor did he discuss the matter with Mr. Englebright during the negotiations. According to him, the purpose of the purchase of Hilo Gas was to do away with the old manufactured gas plant and replace it with butane shipped in from the taxpayer. (R. 41-42.)

The Hilo Gas stock was purchased by the taxpayer rather than by Honolulu Gas because the taxpayer as the distributor of butane had the primary interest in securing the Hilo market. Honolulu Gas was interested in the utility business of distributing gas through the city mains, but was not interested in the distribution of bottled butane. Another reason for the purchase of the stock by the taxpayer rather than by Honolulu Gas was that an order of the Public Utilities Commission would have been necessary before Honolulu Gas could act to purchase the stock, whereas no such order was required in the case of the taxpayer, and in the view of the taxpayer's management, quick action was necessary. Moreover, the purchase of Hilo Gas stock by Honolulu Gas would have made it a public utility company under federal law, a situation which Honolulu Gas wished to avoid. (R. 34-35.)

Following the purchase of the stock on October 6, 1950, Hilo Gas filed a petition on October 20, 1950,

with the Public Utilities Commission to secure the necessary approval for the sale of its assets to Honolulu Gas for approximately $64,000. The hearing on the application was held on October 26, 1950, and on that date, the Commission issued its order, filed November 15, 1950, authorizing Hilo Gas to sell its utility assets to Honolulu Gas for a total consideration of approximately $64,000, $46,000 in cash and the balance by assumption by Honolulu Gas of the liabilities of Hilo Gas. (R. 36, 53-55.) On October 31, 1950, the taxpayer, holding more than the required three-fourths of all of the stock of Hilo Gas, authorized the sale of the utility assets of the company to Honolulu Gas and the sale to itself of merchandise, bottled gas and gas appliances, and notes and accounts relating to this business for $18,500. Possession of the assets was taken after October 31, 1950 (R. 37), and Honolulu Gas eventually scrapped the manufacturing facilities of the old Hilo plant and converted the pumps and distribution system to the distribution of butane (R. 38-39).

Hilo Gas retained certain assets, in addition to the $64,500 cash received from the sale of its properties. These assets included merchandise parts inventory (for older types of appliances) amounting to $1,010.64, certain accounts receivable, and a lease of an office building in Hilo. The Hilo Gas balance sheet as of December 31, 1950, showed assets as follows: cash in bank—$14,498.76; notes receivable (taxpayer—1 percent interest) $50,000; accounts receivable (other) $531.30; inventory—$904.60; total—$65,934.65. On the same date the balance sheet showed accounts payable of

$647.97 and other current and accrued liabilities of $106.80, or total current liabilities of $754.77. (R. 44.)

The book value of the assets sold by Hilo Gas to Honolulu Gas and to the taxpayer exceeded the consideration paid. The assets acquired by the taxpayer by purchase of the stock for $63,897 had a basis on the books of Hilo Gas for tax purposes of $211,684.90, while the total consideration paid in the sale of the assets was $88,754.32. The utility assets, in particular, were sold to Honolulu Gas for $122,930.58 less than their net book value. (R. 37-38.) In November, 1950, the taxpayer obtained tax advice on the tax aspects of the transaction and was advised that the book loss on the sale to Honolulu Gas would be an allowable deduction in a consolidated return filed by the taxpayer and Hilo Gas, but that this would not be an immediate benefit because the taxpayer did not have any net income. Honolulu Gas was advised that it could not acquire the Hilo Gas assets at their book value in order to take advantage of the loss sustained on the abandonment of the manufacturing plant. (R. 42-43.)

Hilo Gas was not immediately dissolved. It continued its corporate existence and activities until September 18, 1956, when it was dissolved by order of the Treasurer of the Territory of Hawaii. (R. 43.) During this period, the taxpayer and Hilo Gas filed consolidated federal income tax returns for the years 1950, 1951, 1952 and 1953. They filed separate returns for the years 1954 and 1955. Both companies filed separate

territorial income tax returns for the years 1950-1955, inclusive. (R. 40.)

From 1950 until its dissolution, Hilo Gas continued to file the annual reports required by Hawaiian law, to hold annual meetings of the stockholders, to hold periodic meetings of directors, to have an independent auditor, to file federal and territorial income tax returns, to pay income taxes, to own property, to receive income, and to pay expenses. (R. 43-44.) While other possible uses of Hilo Gas were considered (R. 46), its specific activities during this period consisted of leasing property which it sublet to Honolulu Gas and to the taxpayer. Hilo Gas received rental, interest and merchandising income and paid expenses for office supplies, janitor service, directors' fees, pensions to retired employees and federal and territorial taxes. (R. 44-45.) Its income and expenses for these years were minimal. In 1951, it reported total income of $19,294.16, total expenses of $18,324.96 and a net income (before taxes) of $969.20. In 1952, it reported a total income of $10,732.76, total expenses of $10,273.26 and a net income (before taxes) of $459.50. In 1953, it reported a total income of $8,600, total expenses of $5,830.71 and a net income (before taxes) of $2,769.29. In 1954, it reported total income of $8,600, total expenses of $6,009.25 and net income (before taxes) of $2,590.75. In 1955, it reported total income of $8,700, total expenses of $6,063.04 and net income (before taxes) of $2,636.96. (R. 41.) On several occasions after 1951, the question of liquidating Hilo Gas was raised by various of the directors but it was decided

to maintain its corporate existence in view of the possible uses that might be made of the corporation. (R. 46.)

By contrast, the taxpayer's earnings increased substantially during this period. In the year 1950, the taxpayer suffered a loss of $93,092. In 1951, it had a net income of $17,445 and in 1952, $39,147. It did not have to pay any federal or territorial income taxes in those years. In 1953, it had a net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954, it had a net income before income taxes of $215,735.66 and after income taxes (as reported) of $104,977. All of the foregoing figures are on an unconsolidated basis. (R. 40-41.)

As a result of the sale of the utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss in 1950 of $117,792.57. (R. 40.) In the consolidated income tax returns filed for the taxpayer and Hilo Gas, the taxpayer included the net loss from the sale of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carry-over to subsequent years. The Commissioner of Internal Revenue disallowed the item on the two-fold ground that (a) in substance, no deductible loss was sustained as the result of the sale of the utility assets of Hilo Gas to Honolulu Gas in 1950; and (b) in the event that a loss was sustained as a result of this transaction, such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by the taxpayer, as a parent, and Hilo Gas as subsidiary, for the calendar year 1950

since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. (R. 46-47.)

On June 4, 1957, the plaintiff, as trustee for the creditors and stockholders of the taxpayer, paid the deficiency with interest assessed against the taxpayer by the Commissioner on account of this disallowance, and a claim for refund was denied. (R. 48-49.)

The second issue in the case has to do with the claim of the taxpayer for a deduction for federal income taxes of Hawaiian territorial income taxes paid on gains not taxable to it under the federal revenue law. These facts, briefly summarized, are as follows:

The stockholders of the taxpayer on November 25, 1955, adopted a plan of complete liquidation which provided for the sale of the refinery facilities to Standard, the sale of the bottled gas business and related assets to Honolulu Gas and the liquidation and dissolution of the corporation. Pursuant to this plan, the refinery facilities were sold to Standard on December 6, 1955, and the bottled gas business and assets were sold to Honolulu Gas on December 31, 1955. Thereafter, and within a period of twelve months from the date of adoption of the plan of liquidation, the affairs of the corporation were wound up, all of the assets of the corporation were distributed in complete liquidation, less assets retained to meet claims, and the corporation was dissolved by order of the Treasurer of the Territory of Hawaii on November 19, 1956. No gain or loss to the taxpayer was recognized on the sale of its assets to Standard and Honolulu Gas, pursuant to the

provisions of Section 337, Internal Revenue Code of 1954. (R. 49-50.)

The gains were, however, taxable under the territorial income tax law and the gains were included in the taxpayer's territorial net income on which it paid total taxes in 1955 of $74,408.15, of which $61,061.59 is allocable to the gains from the liquidation sales. (R. 50-51.) The taxpayer claimed a deduction from its income taxable under federal law for the total amount paid; the Commissioner, however, disallowed the $61,061.59 allocable portion on the ground that Section 265 of the Internal Revenue Code of 1954 "prohibits the deduction of expenses allocable to income exempt from federal income tax." (R. 51.) The appellant paid the deficiency assessed by the Commissioner because of this disallowance and the plaintiff's claim for refund was denied. (R. 51-52.)

The Court below has dismissed the suit for refund, holding that the taxpayer should be denied the benefit of the loss by Hilo Gas through the filing of consolidated returns since it is not established that the principal purpose for the acquisition of the Hilo Gas was not for evasion or avoidance of federal income tax within the meaning of Section 129 of the 1939 Code. In addition the Court also held that aside from Section 129, Section 141 of the 1939 Code, which extends the privilege of making consolidated returns to affiliated groups, may not be utilized to distort income by acquiring a "loss corporation" for a nominal consideration, and then using such corporation's losses to avoid tax. The Court held that the taxpayer, by purchasing

stock at a cost of $63,897.20, which gave it ownership of 95 percent of the stock of a corporation, could not entitle itself to a carry-over of a loss of $117,792.57 attributable to the sale of the assets of the corporation shortly after the acquisition of the stock. (R. 86-87.)

On the second issue, the Court held that under the law and Regulations involved, a taxpayer is not allowed a deduction for the payment of territorial taxes on income which was not taxable here. (R. 94-95.) The Court entered findings of fact and conclusions of law in accordance with its opinion (R. 97-99) and judgment dismissing the complaint (R. 100-101).[1]

SUMMARY OF ARGUMENT

I. The taxpayer here purchased the stock of a corporation in poor financial condition due to obsolete equipment and high costs. The taxpayer then sold virtually all of the assets of the corporation at a prearranged sale, for a price greatly less than the book value of the assets to the corporation, but slightly more than the purchase price of the stock. After the corporation was stripped of its assets, and ready for intended dissolution, the taxpayer deferred dissolution and kept the corporation alive through nominal activities, in order to treat the revived corporation as an

[1]There was a third issue in the case below involving the taxpayer's claim for a deduction in the year of its dissolution of certain expenses incurred in connection with the issuance of its stock. This claim has been abandoned here, and the decision of the Court below holding that the amount was not deductible (R. 91-93) is not in issue here.

affiliate and file consolidated returns with it. The taxpayer filed such consolidated returns for a period of four years, and claimed the book loss to the corporation resulting from the sale of the acquired corporation's assets in 1950 as a carry-forward loss deductible from its earnings in the later years of the period of consolidated returns. After it had served this purpose, the corporation was dissolved.

The Court below properly held that the taxpayer was not entitled to the claimed deduction. It offends specific statutory provisions, including Section 129 of the 1939 Code, and principles of the tax law intended to prevent tax avoidance by distortion of income through the artificial use of corporate devices. The purchase of the stock of a defunct or insolvent corporation in order to acquire a tax loss corporation as an affiliate for consolidated returns has but one purpose, to use the tax loss of another as a deduction from its own income which the taxpayer would not otherwise have. This is flatly prohibited by Section 129 and the finding of the District Court to that effect is supported by evidence and in accord with the decisions of this Court construing Section 129.

In addition, and apart from Section 129, the claimed deduction was not allowable since the privilege of filing consolidated returns cannot be used so to distort income, and the Commissioner could either deny the privilege altogether under Section 141 or allocate this particular loss to the defunct corporation alone, under Section 45. Moreover, affiliation was in reality a sham, which can, on principle, be disregarded for tax pur-

poses. The only real transaction in the case was the purchase of stock in order to acquire the assets, and in such a transaction the only real basis for any gain or loss to the acquiring corporation, the taxpayer here, is the cost of the stock to it, not the book value of the assets to the acquired corporation.

II. The taxpayer was itself liquidated and dissolved in 1956, the proceeds of the liquidation sales of all its assets, less amounts retained to meet claims, being distributed to its stockholders. The gains on the liquidation sale, representing the excess of sales price over cost to the taxpayer, are under Section 337 of the 1954 Code not recognized to the corporation, but taxed, if at all, to the stockholders as a distribution to them in liquidation of a corporation.

The gains to the corporation are, however, taxable to the corporation under Hawaii territorial income tax law. The taxpayer may not deduct the Hawaiian taxes allocable to these gains from its other income taxable under federal law. Section 265 expressly disallows the deduction of any amounts allocable to wholly tax exempt income. Section 265 applies to taxes, and the gains to the taxpayer here, while denominated as nonrecognizable, are in the class of gains wholly exempt from federal tax.

ARGUMENT

I

THE DISTRICT COURT CORRECTLY HELD THAT THE TAXPAYER, HAVING PURCHASED THE STOCK OF ANOTHER CORPORATION AND LIQUIDATED ITS ASSETS IN ACCORDANCE WITH A PRE-ARRANGED PLAN, MAY NOT TREAT THE CORPORATION AS A CONTINUING AFFILIATE IN ORDER TO DEDUCT THE DIFFERENCE BETWEEN THE SALE PRICE OF THE ASSETS AND THE BOOK VALUE OF THE ASSETS AS A LOSS AGAINST ITS OWN INCOME THROUGH THE DEVICE OF FILING CONSOLIDATED RETURNS

A. The finding of the District Court that the primary purpose of the acquisition of the corporation as an affiliate was to evade taxes within the meaning of Section 129 is supported by substantial evidence

Section 129 of the Internal Revenue Code of 1939, Appendix, *infra,* embodies one of the several principles necessary to prevent the avoidance or evasion of tax through artificial or fictitious devices which have no substance or reality. *Commissioner v. British Motor Car Distributors, Ltd.,* 278 F. 2d 392 (C. A. 9th).[2]

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[2]In addition to the House Committee Report quoted in *British Motor Car Distributors, Ltd.* (p. 394) we should like to call the Court's attention to the Senate Committee Report (S. Rep. No. 627, 78th Cong., 1st Sess., pp. 58-59 (1944 Cum. Bull. 973, 1016)), reading as follows:

> The objective of the section, as stated in the report on the House bill, is to prevent the distortion through tax avoidance of the deduction, credit, or allowance provisions of the Code, particularly those of the type represented by the recently developed practice of corporations with large excess profits (or the interests controlling such corporations) acquiring corporations with current, past, or prospective losses or deductions, deficits, or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes. The House report also recognizes that the legal effect of the section is, in large, to codify and emphasize the general principle set forth in *Higgins v. Smith* (308 U.S. 473 [Ct. D. 1434, C.B. 1940-1, 127]), and in other judicial decisions, as to the ineffectiveness of arrangements distorting or perverting

The District Court has found that the taxpayer's claim for a deduction here falls within the prohibition of Section 129 and may not be allowed because the taxpayer has not established that the acquisition of Hilo Gas was not for evasion or avoidance of federal income tax. (R. 86.) We submit that this finding is supported by substantial evidence and is not clearly erroneous. *Commissioner v. British Motor Car Distributors, Ltd., supra; American Pipe & Steel Corp. v. Commissioner,* 243 F. 2d 125 (C. A. 9th); *Elko Realty Co. v. Commissioner,* 260 F. 2d 949 (C. A. 3d), affirming 29 T. C. 1012. As this Court said in *American Pipe & Steel Corp.* (p. 127), dealing with a Section 129 determination by the Tax Court, the finding in this respect "is an express finding of failure of proof, which, if substantially supported by the evidence requires an affirmance of its decision."

The evidence in support of the finding in this case is clear cut. When the taxpayer decided to treat Hilo Gas as a newly acquired affiliate and file consolidated returns with it, Hilo Gas was a practically defunct corporation with a book loss resulting from the sale of virtually all of its assets, ripe for dissolution, and valuable to the taxpayer as a continuing corporate shell only for its book loss as a possible deduction from the taxpayer's income. This was substantially the factual situation present in *British Motor Car Distributors,*

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deductions, credits, or allowances so that they no longer bear a reasonable business relationship to the interests or enterprises which produced them and for the benefit of which they were provided.

Your committee recognizes these facts and is in agreement with these objectives.

American Pipe & Steel and *Elko Realty*. The factual differences in this case do not distinguish it from these prior cases, but rather confirm the rule of those cases. In *British Motor Car Distributors,* the taxpayer purchased the stock of a corporation which had just liquidated all its assets at a loss. Here the loss came into existence after the taxpayer had purchased the stock of the corporation and immediately caused its assets to be sold for a loss at a pre-arranged sale. The conversion of the corporation thereafter into a continuing affiliate in order to get the benefit of the loss was purposed primarily to secure "a very real tax benefit to be realized by them [the taxpayer] *through* the acquired corporation and which they could not otherwise have realized." (278 F. 2d, p. 394.)

Indeed, this was the very situation in *American Pipe & Steel Corp., supra.* There, the taxpayer purchased cheaply the stock of a corporation in poor financial condition and immediately thereafter sold its assets at a liquidation sale, resulting in substantial tax losses. As this Court said (243 F. 2d, p. 127): "for a total cost of $11,248.96 to American Pipe, it acquired tax losses of $400,393.91". The taxpayer's attempt to carry forward this loss as a deduction against its income in later years through the device of filing consolidated returns with the stripped corporation was denied. The taxpayer's claim to a business reason—that it acquired the corporation as an affiliate because of the potential value of its assets—did not, this Court held (p. 128) "over-shadow the conclusion that the acquisition was for a huge potential tax benefit." Here,

as in *American Pipe & Steel* (p. 128), after the acquisition of the stock of the corporation and the liquidation of its assets, the purported affiliate "was a mere corporate shell." And in *Elko Realty,* as the Court below pointed out (R. 90), while the taxpayer never saw the books of the two acquired corporations prior to purchasing their stock, nevertheless the taxpayer *had reason to know* that the corporations were operating at a loss. The case here is stronger than *Elko;* the taxpayer here emphasizes that it never saw the books of Hilo Gas before its purchase of the stock, but the significant fact is that the taxpayer here *actually knew* that Hilo Gas was in financial difficulty, and that its manufacturing plant was obsolete and its manufacturing costs were high. (R. 29-31.)

The taxpayer's objections to the finding below, as well as its efforts to distinguish the decided cases, are, we submit, without merit. The taxpayer's argument, essentially, is that the acquisition of Hilo Gas as a corporate entity was for a business purpose, not to avoid taxes, because at the time it acquired the stock of Hilo Gas, no consideration was given by it to the tax aspects of the transaction, it did not know what the book value of the Hilo Gas assets was until after it had decided to purchase the stock, and its primary interest in Hilo Gas was that the Hilo Gas distribution system and market would furnish the taxpayer with an outlet for its product. The fallacy in the taxpayer's argument, however, is that the facts of business purpose, which we do not dispute, justified the acquisition by the taxpayer of the *assets* of Hilo Gas and the liquida-

tion of Hilo Gas as *a corporate entity,* precluding its continuance in existence as an affiliate of the taxpayer. Indeed, this was exactly what the taxpayer intended at the time that it purchased the stock of Hilo Gas. (R. 43.) It had arranged for the sale of virtually all of the assets of Hilo Gas prior to purchase of the stock. The taxpayer proceeded to carry out its plan to liquidate Hilo Gas as a corporation. On October 31, 1950, the assets were sold and Hilo Gas was only a corporate shell bound for dissolution. (R. 44.) The later revival of Hilo Gas as a corporation in November, 1950, to continue in existence as an affiliate of the taxpayer was admittedly prompted by tax considerations (R. 42-43); it had no business purpose, and the taxpayer can show none. The taxpayer had provided for the operation of the business formerly conducted by Hilo Gas through Honolulu Gas and itself; it had no need of Hilo Gas as a lessor, and the possible uses of Hilo Gas for other purposes were outshadowed by its actual use as a tax loss corporation.

The continued existence of Hilo Gas as a corporate entity was of no value to the taxpayer except as a tax loss and its acquisition for that purpose thus violated the basic principle underlying Section 129. As the Senate Committee Report states (S. Rep. No. 627, *supra,* p. 60 (1944 Cum. Bull., p. 1017)): "Basic to the deduction, credit, and allowance provisions is a continuing enterprise so conducting its affairs." This is the principle of the decisions in *British Motor Car Distributors, Ltd., supra; American Pipe & Steel Corp., supra;* and *Elko Realty Co., supra.* The deci-

sion below is correct as a matter of fact and law. Viewing the entire transaction involved, it becomes clear that the acquisition of Hilo Gas as a corporate entity, distinguished from its assets was primarily for the purpose of evading or avoiding taxes upon the income of the taxpayer, within the terms and spirit of Section 129.

B. Apart from Section 129, the taxpayer's claim to the deduction is prohibited by other specific provisions and basic principles of the revenue laws

As we have already noted, Section 129 is only one of the measures which stands as a bar against the evasion or avoidance of income taxes through the use of artificial corporate devices which distort income. Indeed, the Court below held that, apart from Section 129, the taxpayer here was not entitled to the privilege of filing consolidated returns under Section 141, Appendix, *infra,* in order to secure the benefit of the Hilo Gas loss. In the words of the Court below (R. 87) this privilege may not "be utilized to distort income by acquiring a 'loss corporation' for a nominal consideration, and then using such corporation's losses to avoid taxes." *David's Specialty Shops v. Johnson,* 131 F. Supp. 458 (S.D. N.Y.); *J.D. & A.B. Spreckels Co. v. Commissioner,* 41 B.T.A. 370. The *Spreckels* case, approved by Congress (see S. Rep. No. 627, *supra,* p. 60) is, we submit, on all fours with the case at bar. The case of *Bishop Trust Co. v. Commissioner,* 36 B.T.A. 1173, upon which the taxpayer relies, is factually distinguishable. There the taxpayer acquired another trust

company in order to liquidate it without loss to its investors, thereby preventing the spread of financial panic which would have endangered the taxpayer and also securing for itself the good will and future patronage of the investors in the acquired corporation.

Moreover, even if the privilege of filing consolidated returns were to be allowed to the taxpayer here, the Commissioner had ample authority to disallow the particular claimed deduction by allocating it solely to Hilo Gas, in order to prevent a distortion of income. The authority so to allocate is expressly provided in connection with consolidated returns by Section 141(b), and by Section 141(i) in conjunction with Section 45, Appendix, *infra*. It is a necessary check upon the abuse of the privilege of filing consolidated returns. *National Securities Corp. v. Commissioner,* 137 F. 2d 600 (C. A. 3d). In that case, the Court held that a parent corporation, which had sustained the major loss on a stock investment, could not maintain the transfer of the loss to a subsidiary by transfer of the stock, against the Commissioner's allocation of the loss to it, rather than the subsidiary, under Section 45.

In addition to specific statutory provisions, the taxpayer's claim to a deduction was properly denied because the taxpayer is not the corporate entity or enterprise which suffered the loss. As far as it is concerned, the property sold for $84,500 cost it $63,897. The general rule is that the taxpayer "who sustained the loss is the one to whom the deduction is allowed." *New Colonial Co. v. Helvering,* 292 U. S. 435, 440-441; *Libson Shops Co. v. Koehler,* 353 U. S. 282; *Bookwalter v.*

Hutchens Metal Products Co. (C. A. 8th), decided June 30, 1960 (6 A.F.T.R. 2d 5068); *Mill Ridge Coal Co. v. Patterson,* 264 F. 2d 713 (C. A. 5th). A taxpayer may not, by acquisition of, or merger or consolidation with another corporate entity which is at the time a mere corporate shell, claim for itself the tax loss suffered by the other, particularly the loss which reduced it to a shell. Furthermore, the continuance of Hilo Gas as a corporate entity affiliated with the taxpayer, was a meaningless transaction; the carrying out of the challenged tax event, i.e., the maintenance of a period of affiliation during which a loss occurred, was "unreal or a mere sham" which may be disregarded for tax purposes. *Higgins v. Smith,* 308 U. S. 473, 477.

Finally, the transaction upon which the taxpayer here relies to show innocence of tax evasion and a business purpose was a transaction for the acquisition of the assets of Hilo Gas, through purchase of its stock. In such a transaction the *only* real basis for gain or loss to the acquiring taxpayer is the cost of the stock to it, not the cost basis to the acquired or transferor corporation. *United States v. Mattison,* 273 F. 2d 13 (C. A. 9th); *United States v. M.O.J. Corp.,* 274 F. 2d 713 (C. A. 5th); *Georgia-Pacific Corp. v. United States,* 264 F. 2d 161 (C. A. 5th); *Kanawha Gas & Utilities Co. v. Commissioner,* 214 F. 2d 685 (C. A. 5th); *Commissioner v. Ashland Oil & R. Co.,* 99 F. 2d 588 (C. A. 6th); *Prairie Oil & Gas Co. v. Motter,* 66 F. 2d 309 (C. A. 10th); *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T. C. 74; *Muskegon Motor Spe-*

cialists Co. v. Commissioner, 35 B.T.A. 851. The rule (known as the *Kimbell-Diamond* rule) has been applied where the assets were acquired by the taxpayer in a two-step transaction of purchase of the stock of a corporation and surrender of the stock for assets, dissolving or liquidating the corporation itself. But the principle is clearly applicable to a case where the taxpayer purchases the stock in order to sell the assets to itself or another, to be followed by liquidation of the corporation. The difference between the two cases is not material: In one the liquidation of the corporation is accomplished simultaneously with the liquidation of its assets; in the other the liquidation of the corporation follows the liquidation of its assets. In both the purpose is to acquire assets, not stock. As this Court said in *United States v. Mattison* (273 F. 2d, p. 17):

> * * * when a taxpayer who is interested primarily in a corporation's assets first purchases the stock and then liquidates the corporation in order to acquire the desired assets, the separate steps taken to accomplish the primary objective will be treated as a single transaction. Thus, even though the objective was accomplished in form by a purchase of stock, the substance of the transaction is a purchase of property.

Here, too, as in *Mattison* (p. 19), the intention to acquire assets is confirmed by the fact that the objective was "to consummate a pre-arranged sale of the assets."

Moreover, where the transaction is one to acquire assets, the fact that the purchased corporation was

kept alive for a temporary period and that during this period consolidated returns were filed for it and its new parent, the purchaser, is not decisive. The fact of consolidated returns does not alter the essential or real nature of the transaction as a purchase of assets having a basis to the purchaser, for tax purposes, of the price of the stock. *Commissioner v. Ashland Oil & Gas Co., supra, Kanawha Gas & Utilities Co. v. Commissioner, supra* (214 F. 2d, pp. 689-691); *Muskegon Motor Specialties Co. v. Commissioner, supra.* The original cost basis to the acquired corporation is not a real measure of gains or losses to the acquiring corporation, and it does not become a real measure because the acquiring corporation files consolidated returns with the corporate shell of the acquired corporation.

II

THE DISTRICT COURT CORRECTLY HELD THAT THE TAXPAYER MAY NOT DEDUCT THE AMOUNT OF TERRITORIAL TAXES ALLOCABLE TO GAIN NOT SUBJECT TO FEDERAL TAX

The second question in this case arises not out of the liquidation of Hilo Gas, but out of the liquidation of the taxpayer itself. Briefly stated, on November 25, 1955, the stockholders of the taxpayer adopted a plan for its complete liquidation, to be accomplished by the sale of its refinery assets to Standard Oil and of its bottled gas business to Honolulu Gas. This liquidation sale was completed within a year and re-

sulted in gains, but under Section 337 of the 1954 Code, Appendix, *infra*, the gain was not recognizable to the taxpayer. The gain was, however, taxable to the taxpayer under the Hawaii territorial tax law and in 1955 the taxpayer paid a Hawaii income tax of $74,408.15 of which $61,061.59 was allocable to the gains from the liquidation sale. This allocable portion of the gains was claimed by the taxpayer as a deduction on its federal income tax return but disallowed by the Commissioner under Section 265 of the 1954 Code, Appendix, *infra,* and the disallowance was sustained by the Court below. We submit that the decision below is correct because (1) Section 265 prohibits the deduction of taxes allocable to tax-exempt income; and (2) the gains to the taxpayer from its liquidation sale were wholly exempt from federal income tax within the meaning of Section 337.

A. Section 265 requires the disallowance of taxes allocable to income exempt from federal tax

Section 265(1) provides that no deduction shall be allowed for "(1) *Expenses.*—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income * * * wholly exempt" from income tax. The taxpayer contends that taxes are not "expenses" and are therefore not covered by Section 265 at all, regardless of whether the taxes are allocable to exempt income. As the taxpayer admits, however, there is no ruling to this effect. On the contrary, it has been consistently held by prior decisions of the Tax Court that the predecessor to Sec-

tion 265 (Section 24(a)(5) of the 1939 Code) did apply to taxes. *Marsman v. Commissioner,* 18 T. C. 1, affirmed on other grounds, 205 F. 2d 343; *Heffelfinger v. Commissioner,* 5 T. C. 985; *Curtis v. Commissioner,* 3 T. C. 648; *Keith v. Commissioner,* decided December 9, 1942 (P-H T. C. Memorandum Decisions, par. 42,630); *Halleran v. Commissioner,* decided August 10, 1942 (P-H T. C. Memorandum Decisions, par. 42,456).

There is no reason for disturbing these decisions, especially since the section has been substantially reenacted by Congress. The only argument the taxpayer has is that the sub-heading of the section refers only to expenses, and "expenses" are for *some,* not all, tax purposes distinguished from "taxes"; the taxpayer concedes that the terms are not mutually exclusive. (Br. 82.) Moreover, the substantive terms of the revenue statute involved here apply to "any amount otherwise allowable as a deduction" which clearly includes taxes; and the sub-heading cannot control the plain meaning of the substantive terms of the section. *United States v. Minker,* 350 U.S. 179, 185. The taxpayer's claim (Br. 80) that, by adding the heading "expenses" in the 1954 Code, Congress intended to limit the prior scope of the section which otherwise is the language of Section 24(a)(5) of the 1939 Code, as amended, is directly refuted by the express declarations of Congress. The Senate and House Committee Reports state as follows (H. Rep. No. 1337, 83d Cong., 2d Sess., p. A65 (3 U.S.C. Cong. & Adm. News (1954), pp. 4017, 4202), S. Rep. No.

1622, 83d Cong., 2d Sess., p. 226 (3 U.S.C. Cong. & Adm. News (1954), pp. 4621, 4862):

> Subsection (a) is the same as section 24(a)(5) of the 1939 Code. Subsection (b) contains the same rule as section 23(b) of the 1939 Code. No substantive changes are made in either of these provisions.

B. The gains from the sale and liquidation of the taxpayer were wholly exempt from tax within the meaning of Section 265

The purpose of Section 265 seems clear enough. It is intended to disallow a deduction which is directly connected with a non-taxable gain.[3] The taxpayer argues that the gain from the sales and liquidation of a corporation are not "exempt" from tax but are "not recognized" for tax purposes. (Br. 70.) This verbal distinction, according to the taxpayer, has a substantive basis, to-wit: The tax on gain which is not recognized is simply postponed and will eventually have to be paid, and therefore the gain is not "wholly exempt" from taxation. It is not necessary here to determine whether the term "wholly exempt" as used in Section 265 includes gain "not recognized", since under Section 337, the gain from the liquidation sales of a corporation is wholly exempt from tax to the corporation; the tax is not merely postponed. As the taxpayer's own argument demonstrates (Br. 70-75) the purpose of Section 337 was to provide for only

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[3]It is worth noting that even before the predecessor Section 24(a)(5) was enacted, it was held on *principle* that expenses of producing non-taxable income were not deductible. *Lewis v. Commissioner*, 47 F. 2d 32 (C. A. 3d).

one tax upon the gains from the liquidation sale of a corporation—to its stockholders, and not to the corporation.[4] The corporation itself, the taxpayer here, will never pay a tax on these gains, since it is to be dissolved and its existence, as a taxpayer and otherwise, terminated.

In this light, the decision in *Cotton States Fertilizer Co. v Commissioner,* 28 T. C. 1169, is not in point, since there the tax was merely postponed, not wholly relieved. Similarly, the decisions in the cases involving expenses of liquidation cited by the taxpayer (*Commissioner v. Wayne Coal Mining Co.,* 209 F. 2d 152 (C. A. 3d); *United States v. Arcade Co.,* 203 F. 2d 230 (C. A. 6th); *Pacific Coast Biscuit Co. v. Commissioner,* 32 B. T. A. 39; *Tobacco Products Export Corp. v. Commissioner,* 18 T. C. 1100) are not in point since the expenses there involved were general expenses of a liquidation, incurred regardless of the gains or losses from liquidation sales; the issue in those cases was whether such expenses were necessary and ordinary expenses, not whether they were allocable to tax-exempt income.

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[4]Moreover, the gains to the stockholders will be measured by a different basis than the gain to the corporation—the cost or basis of their stock, not the cost or other basis of the assets to the corporation.

CONCLUSION.

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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(Appendix Follows.)

Appendix.

Appendix

Internal Revenue Code of 1939:

SEC. 45. [as amended by Section 128(b) of the Revenue Act of 1943, c. 63, 58 Stat. 211]. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U. S. C. 1952 ed., Sec. 45.)

SEC. 129. [as added by Section 128(a) of the Revenue Act of 1943, *supra*]. ACQUISITIONS MADE TO EVADE OR AVOID INCOME OR EXCESS PROFITS TAX.

(a) *Disallowance of Deduction, Credit, or Allowance.*—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not

controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

(b) *Power of Commissioner to Allow Deduction, Etc., in Part.*—In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate

the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2). (26 U. S. C. 1952 ed., Sec. 129.)

SEC. 141 [as amended by Section 301, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137]. CONSOLIDATED RETURNS.

(a) *Privilege to File Consolidated Returns.*— An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of

the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

* * * *

(i) *Allocation of Income and Deductions.*—For allocation of income and deductions of related trades or business, see section 45.

* * * *

(26 U. S. C. 1952 ed., Sec. 141.)

Internal Revenue Code of 1954:

SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.

No deduction shall be allowed for—

(1) *Expenses.*—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest

(whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

* * * *

(26 U. S. C. 1958 ed., Sec. 265.)

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) *General Rule.*—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

* * * *

(26 U. S. C. 1958 ed., Sec. 337.)

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.265-1. EXPENSES RELATING TO TAX-EXEMPT INCOME.—NONDEDUCTIBILITY OF EXPENSES ALLOCABLE TO EXEMPT INCOME.

* * * *

(b) *Exempt income and nonexempt income.*—

(1) As used in this section, the term "class of exempt income" means any class of income (whether or not any amount of income of such class is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Internal Revenue Code of 1954. For purposes of this section, a class of income which is considered as wholly exempt from the taxes imposed by subtitle A includes any class of income which is—

(i) Wholly excluded from gross income under any provision of subtitle A, or

(ii) Wholly exempt from the taxes imposed by subtitle A under the provisions of any other law.

(2) As used in this section the term "nonexempt income" means any income which is required to be included in gross income.

* * * *

No. 16,859

IN THE

United States Court of Appeals

For the Ninth Circuit

HAWAIIAN TRUST COMPANY LIMITED, a Hawaii corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation,

Appellant,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Hawaii

APPELLANT'S REPLY BRIEF

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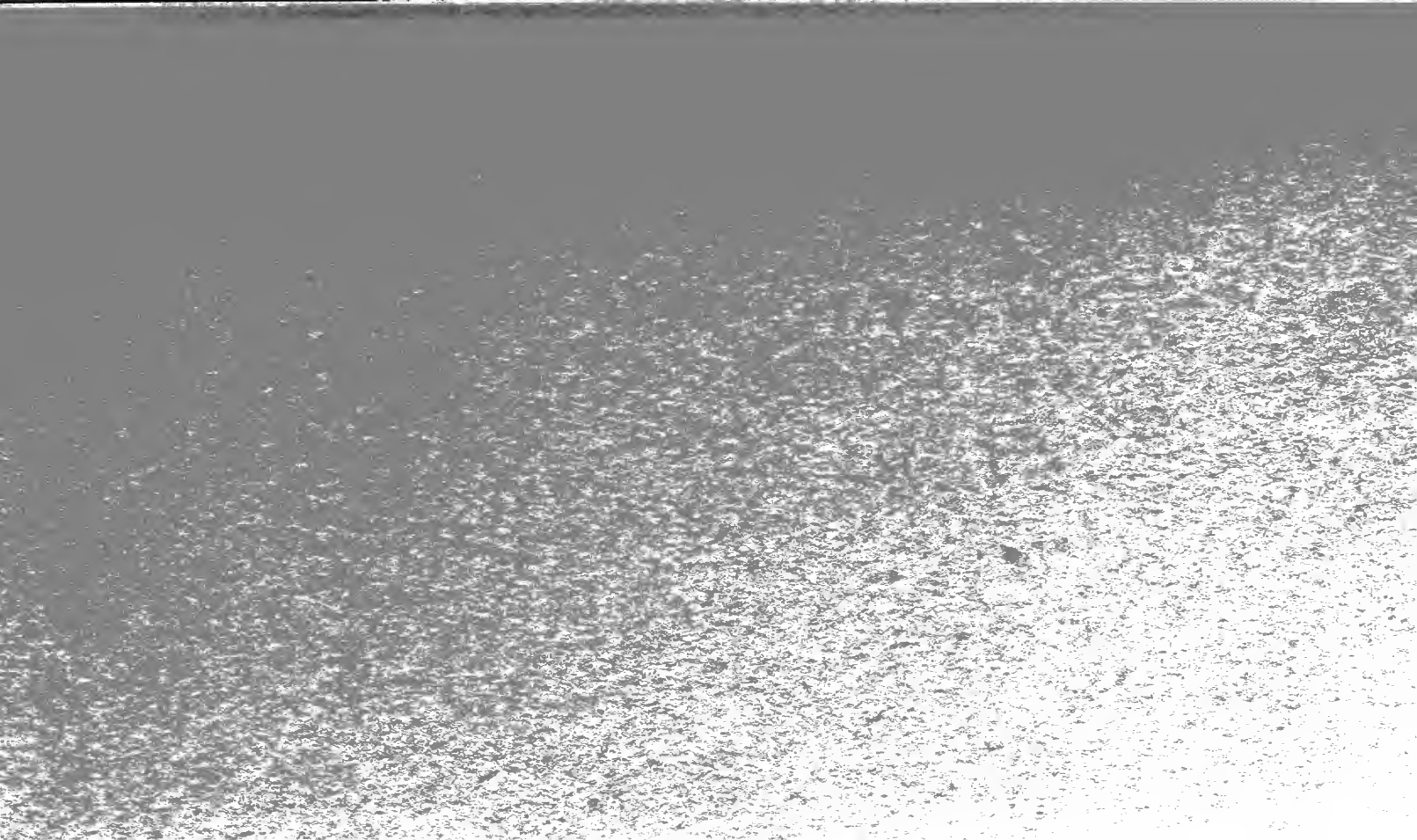

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APPELLANT'S REPLY BRIEF

FIRST ISSUE: REFINERS WAS ENTITLED TO CARRY FORWARD AS A CONSOLIDATED NET OPERATING LOSS TO 1953 THE NET OPERATING LOSS SUFFERED IN 1950 BY HILO GAS.

A. The applicability of Section 129.

The government asserts that the District Court's conclusion that the primary purpose of the acquisition of Hilo Gas was to evade taxes is supported by substantial evidence. What is that evidence? According to the government's brief, although there was a business purpose justifying the acquisition by Refiners of Hilo Gas, or at least its assets, there was no business purpose to justify the continued existence of Hilo Gas as an affiliate. (Gov. Br. 18-22.) Assuming for the sake of argument that this

is correct,[1] it falls far short of the evidence required to support the District Court's finding.

Section 129 authorizes disallowance of a deduction if a person acquires control of a corporation "*and the principal purpose for which such acquisition was made*" is tax evasion. As noted by the Tax Court in *American Pipe & Steel Corp.*, 25 T. C. 351, 365, 366 (1955), it is the *intent* of the taxpayer, his *state of mind,* which must be determined. Clearly, it is the taxpayer's intent or state of mind at the time the acquisition was made which must be determined, and it is the only thing to be determined.[2] What happens *after* the acquisition is surely immaterial except as illuminating earlier intent in situations where such intent is indistinct or unproved.

In this case it is abundantly clear that *at the time of the acquisition* of control of Hilo Gas, Refiners had no tax evasion purposes whatever. The acquisition of Hilo Gas was for business reasons alone (to obtain the Hilo market for butane and the Rock Gas distribution business on Hawaii), "at the time of the acquisition of the stock

---

[1]The record does not show that the continued existence of Hilo Gas as an affiliate of the taxpayer "was admittedly prompted by tax considerations." The only thing in the record on this point is Mr. Dunn's opinion dated November 15, 1950 "pointing out that the loss on the sale to Honolulu Gas would be an allowable deduction in a consolidated return filed by Refiners and Hilo Gas, but that this would not be an immediate benefit because Refiners did not have any net income." (R. 42-43.) There is no evidence that the reason for keeping Hilo Gas alive was for tax purposes. Indeed the only evidence is the stipulation of the reasons for maintaining the corporate existence, which were various possible *business* uses of the corporation. (R. 46.) Hilo Gas was not dissolved after its losses had been used up, as alleged; it continued in existence until 1956 when Refiners itself was dissolved.

[2]The government seems to think that the time for measuring the taxpayer's intent is the time when it files the consolidated tax return, rather than the time of the acquisition. (Gov. Br. 18.) This is indeed to read something into the statute which is not expressly there, contrary to this court's injunction in *C.I.R. v. British Motor Car Distributors, Ltd.*, 278 F.2d 392, 395 (9th Cir. 1960).

* * * no consideration was given by Refiners to the tax aspects of the transaction," Refiners did not even know the book value of the Hilo Gas assets, and it was not until the month *after* the acquisition of control that Refiners considered the tax aspects of the transaction. These facts have been stipulated (R. 27-34, 41-43) and the government does not dispute them (Gov. Br. 20). If Refiners bought control of Hilo Gas for business reasons alone and without considering taxes, as is admitted, how can the subsequent history of Hilo Gas possibly change the taxpayer's intent and purpose in making the acquisition from a business purpose into a tax evasion purpose? It cannot.[3]

The government attributes great significance to the fact that Refiners knew Hilo Gas was in financial difficulty, thereby likening this case to *Elko Realty Co.*, 29 T. C. 1012 (1958), *aff'd* per curiam 260 F.2d 949 (3d Cir. 1958). (Gov. Br. 20.) We think this point is thoroughly disposed of in our opening brief. (Op. Br. 31-37.) Past operating losses of Hilo Gas were of no tax evasion significance unless Refiners attempted to carry them forward, which it did not and could not do. Knowledge that the Hilo Gas manufacturing plant was obsolete likewise would have no tax evasion significance unless Refiners also knew the book value and tax basis for these assets so that it might have planned to sell them at a loss. For

[3]In all of the cases cited by the government, there have been findings that there was no business purpose for the acquisition or that the tax evasion purpose which was evident at the time of the acquisition was predominant. Thus in *British Motor Car Distributors, supra,* "It is not claimed that there was any business purpose in the acquisition" and "it is clear that the principal purpose of the acquisition * * * by the new owners was to avoid taxes." In *Elko Realty Co.*, 29 T. C. 1012 (1958), the Tax Court found that "no bona fide business purpose was served by the acquisition". (29 T. C. 1018.) In *American Pipe, supra,* Lane knew all about the potential tax benefit *at the time of the acquisition* and there was no reasonable business explanation for the acquisition. These cases have nothing in common with ours.

all that Refiners knew the assets might have been so fully depreciated that the remaining tax basis was less than the market value. However, Refiners did not have this information until *after* the acquisition was completed. Since Refiners already had a substantial loss of its own (almost $100,000) it was not shopping for a tax loss company.

Also the government makes a great point of the "pre-arranged sale" of the Hilo Gas utility assets to Honolulu Gas, as if this proved the requisite tax evasion intent. (Gov. Br. 14, 19, 21.) We cannot find any tax evasion plot in this. Refiners did not want the utility assets; it was not and did not want to become a regulated utility; indeed it had previously suggested to Hilo Gas a way out of its difficulties which would have eliminated the utility business in Hilo altogether. (R. 27, 31, 34.) On the other hand, there were sound business reasons why Honolulu Gas did not purchase control of Hilo Gas. (R. 34-35.) Quick action was necessary to save the gas business in Hilo. Lyman and Hutchinson offered to sell stock, not assets. (R. 31-34.) Under the circumstances, what was more natural than the course actually taken. When Refiners acquired Hilo Gas it didn't know anything about the book value of the Hilo Gas assets or whether they could be sold at a profit or a loss taxwise; consequently the "pre-arranged" sale to Honolulu Gas was not a tax evasion plan. Further, if anybody had been thinking about tax evasion, Honolulu Gas rather than Refiners should have made the acquisition because Honolulu Gas had profits and could use a tax loss, whereas Refiners could not.

It has long been established that corporate activity is not a prerequisite for continued affiliation. The sole test of what is a member of an affiliated group is statutory, and the only requirement is the requisite stock ownership. Sections 141(a), (d) and (e), I.R.C. 1939; Regs. 129 §§ 24.2(b) and 24.11(c).

> "* * * If conditions necessary to affiliation exist, the status will not be denied merely because one of the affiliated corporations is inactive; there is nothing in the statute which indicates that activity is essential to affiliation." 8 Mertens, *Law of Federal Income Taxation,* § 46.08

The foregoing statement from Mertens is amply supported by the cases, including two decisions of the Supreme Court.

Burnet v. Aluminum Goods Co., 287 U.S. 544 (1933). In 1914 the manufacturing company purchased all the stock of the sales company and the sales company engaged in selling goods manufactured by its parent. In 1917 the sales company was chiefly engaged in closing up its business preparatory to formal dissolution (in February 1918), and *all* of its assets and liabilities were disposed of by the end of 1917 and it did not do any business after that date. In 1917 the two corporations filed a consolidated return for the purpose of the excess profits tax. The Seventh Circuit (56 F.2d 571) held that the liquidation in 1917 ipso facto terminated the affiliation, so that the loss was suffered outside the period of affiliation, stating that "the statute governing affiliated returns contemplated its application to active companies only." The Supreme Court granted certiorari to resolve an alleged conflict between this decision of the Seventh Circuit and decisions of the Court of Claims (*Utica Knitting Co. v. United States,* 68 Ct.Cl. 77, VIII-2 *Cum. Bull.* 352) and the Second Circuit (*Autosales Corp. v. Commissioner, infra*) that activity was *not* a requirement for affiliation. (287 U.S. 546.) Thus the Supreme Court thought it was settling this issue. It held:

> "Since complete stock ownership is made the test of affiliation applicable here under Article 77 of Treasury Regulations 41 and § 1331 of the Revenue Act of 1921, no ground is apparent for saying that the corporations ceased to be affiliated, merely be-

> cause, without change of corporate control, one of them was being liquidated. The findings do not reveal that the liquidation of the Sales Company was completed, that it ceased to do any business or to function as a corporation before the end of 1917. Neither statute nor regulations recognize that affiliation may be terminated by the mere fact that such liquidation is being carried on, * * *." (p. 548)

Ilfeld Co. v. Hernandez, 292 U.S. 62 (1934). In 1929, before the end of November, two subsidiaries sold all their property to outside interests and after paying their debts, paid over the balance to the parent on December 23. Both subsidiaries were dissolved on December 30. The parent made a consolidated return in 1929 and claimed that it was entitled to deduction of the losses resulting to it from the liquidation of the two subsidiaries. The Supreme Court held that the liquidating distributions were *during* a consolidated return period and that the parent could not deduct the loss.

> "* * * The record conclusively shows that each subsidiary handed over the balance before the dissolution was consummated and during the consolidated return period." (p. 66)
>
> "* * * The payment of the liquidating dividends was made during the return period and was the last step leading up to the action of directors and stockholders for the dissolution of the subsidiaries." (p. 67)

Note that in this case the subsidiaries sold *all* of their property before the end of November, paid their debts and made a final distribution to the petitioner on December 23 and were dissolved December 30. The Supreme Court held that the consolidated return period lasted until the dissolution on December 30, despite the fact that the subsidiaries could not possibly have engaged in any business activities after the end of November.

Autosales Corporation v. Commissioner of Int. Rev., 43 F.2d 931 (2d Cir. 1930). A chocolate company owned

all of the stock and controlled all of the property and franchises of a weighing company. The weighing company was not actively engaged in business, all of its machines and franchises being operated by the chocolate company. It was contended by the taxpayer that the two corporations were not affiliated for consolidated return purposes because the weighing company was inactive. The court held to the contrary stating:

> "* * * That the subsidiary is wholly inactive and but a bookkeeping department of the parent company is immaterial, * * *. * * * We are entirely clear that within the taxable years in question the chocolate company and the weighing company were affiliated corporations; a consolidated return was required, * * *." (p. 933)

Hancock Construction Co. et al., 11 B.T.A. 800 (1928) (Acq. VIII-1 *Cum. Bull.* 19). Five corporations were controlled by one individual and were all engaged in the real estate business in 1918, 1919 and 1920 except the Robbins Company, which was inactive during 1920. The Commissioner took the position that the Robbins Company was not affiliated during 1920 with the other companies and that the proportionate part of the net loss for 1919 attributable to it could not be applied against the 1920 consolidated net income. In the latter part of 1919 the Robbins Company turned over its property to a creditor and was left without any assets whatever. The Robbins Company was not dissolved at that time, but merely suspended its activities awaiting a favorable opportunity again to engage in business. The company had no income or expense in 1920 and was without assets of any kind. However, the company was at all times during 1920 under the law able to transact business. The court held that the Commissioner erred in determining that the Robbins Company was not affiliated during 1920, and in refusing to apply against the consolidated net income for 1920 the 1919 loss attributable to Robbins Company.

"The evidence adduced clearly establishes the fact that during 1920 the Robbins Construction Co. was merely inactive. It had not been dissolved either voluntarily or involuntarily. Its stock was still outstanding, held as above indicated, and it was in a position to transact business. Does the fact that this company was inactive and made no return for 1920 because it had no income or expense preclude it from being a member of an affiliated group of corporations, provided the other requisites of the statute have been met? We think not. * * *

"Section 240(b) of the Revenue Act of 1918, *supra,* does not indicate that activity on the part of a corporation is essential to affiliation. * * *" (p. 804)

Joseph Weidenhoff, Inc., 32 T.C. 1222 (1959). On September 12, 1949 Fostoria Corporation sold all of its assets and terminated its business operations. It was kept in existence until July 31, 1952 when the stockholders adopted a resolution to dissolve and a certificate of dissolution was filed. There were no activities from 1949 to 1952 except nominal activities for the parent. Held, that Fostoria remained a member of the affiliated group until it was formally dissolved.

"* * * The sole test of what is a member of an affiliated group is statutory; and the only requirement is the requisite stock ownership. * * *" (p. 1233)

The sale of assets, the cessation of operations and the lack of income did not relieve Fostoria of filing a tax return, and if it was required to file a return at all it was required to join in the consolidated returns filed for the affiliated group, which it did.

See also *Bowie Lumber Co., Ltd.,* 20 B.T.A. 342 (1930) *and G. C. M. 2019,* VI-2 *Cum. Bull.* 128.

Certainly, the property, activities and assets of Hilo Gas in 1950 to 1956 were more substantial than those of the inactive corporations in the cases above referred to. During these years it had property, income and expenses,

it filed tax returns and paid taxes, it filed the annual Hawaii Corporation Exhibit, it held meetings of stockholders[4] and directors, for a time it maintained the payroll and provided other services for Refiners and Honolulu Gas[5] in Hilo, it maintained bank accounts, it made *new* leases of property in 1951, 1952 and 1955 and subleased office space to Honolulu Gas and Refiners. At any time during this period it could have been used as a financing vehicle or as an Isle-Gas distributor, as was under consideration. It was not formally dissolved until September 18, 1956. (R. 41-46.) The activities of Hilo Gas went beyond transactions carried on for the single purpose of liquidation of assets and consequently the corporation was still doing business. See *Willis v. Commissioner of Internal Revenue,* 58 F.2d 121, 123 (9th Cir. 1932).

Regs. 118 § 39.52-1 states:

> "A corporation is not in existence after it ceases business and dissolves, retaining no assets, whether or not under state law it may thereafter be treated as continuing, * * *."

Rev. Rul. 56-483, 1956-39 I.R.B. 15 rules that a corporation which had ceased all business operations and had no further sources of income but had retained a small sum of cash for the stated purpose of paying annual state taxes to preserve the corporate charter was required to file a Federal income tax return. This court has held that simply because a corporation has ceased all operations does not mean that it has ceased business and dissolved under this regulation. *Berry v. Commissioner of Internal Revenue,* 254 F.2d 471 (9th Cir. 1957). If Hilo Gas was sufficiently active to be a "corporation" under Section 52 so as to be required to file income tax returns, it must

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[4]Hilo Gas never became a wholly-owned subsidiary of Refiners. (R. 35.)

[5]Honolulu Gas was not an affiliate of Hilo Gas, although it had some of the same stockholders as Refiners. (R. 25-26.)

similarly be a "corporation" under Section 141 and as such continued as a member of an affiliated group.

B. Denial of the loss carry forward for reasons apart from Section 129.

Apart from Section 129 other arguments are advanced by the government to deny the privilege to which the taxpayer is entitled under Section 141. We submit that these arguments and the principles and authorities cited are inapplicable to this factual situation and may readily be disposed of.

First, it is said that the utilization of the consolidated return privilege here would be to "distort" income, relying on *Spreckels, David's Shops* and distinguishing *Bishop Trust.* (Gov. Br. 22.) As noted in our opening brief, if the loss of the subsidiary is realized *after* affiliation[6] it not only may, it must, be included in the consolidated return under Section 141 and the Regulations and if there is any distortion it is one deliberately provided by Congress and the Treasury. (Op. Br. 52-55.) *Spreckels* is not on "all fours," as it is simply a case where there was no business reason at all for the acquisition, only a tax reason. At the time of the acquisition the stock of the subsidiary had no value. No business reason for the acquisition was ever claimed by the taxpayer. (Op. Br. 55-58.) *David's Shops* is another case where there was found to be no business reason for the acquisition, but if there is a business reason the court said the tax benefit from filing consolidated returns cannot be denied even though the stock of the subsidiary cost the parent nothing. (Op. Br. 60-61.) Actually, *Bishop Trust* is closer to this case than any other. The Commissioner contended that Waterhouse Trust was hopelessly insolvent when acquired, that it was held only

[6]The facts here are that the period of affiliation commenced *prior* to October 25, 1950 and the subsidiary's loss could not and did not occur until October 31, 1950. (R. 35-37.)

for the purpose of liquidation, and therefore that it could not be an affiliate of Bishop Trust. (36 B.T.A. p. 1179.) The Commissioner's contentions there are strikingly similar to the government's contentions here. The Board held that the acquisition was for a *bona fide* business reason, and that the Commissioner's determination denying affiliation was error.

The government's next point is that the Commissioner could have allocated the loss solely to Hilo Gas under Section 141(b) or Section 141(i) and Section 45. Section 141(b) merely directs the Secretary to prescribe regulations in order that the tax liability of an affiliated group and its members may clearly reflect income. Acting under this, the Secretary has prescribed the Consolidated Return Regulations which taxpayer here admittedly has complied with and under which a post-affiliation loss of a subsidiary is to be used against the parent's profits. (Op. Br. 18-23, 52-55.) Section 141(i) says that for allocation of income and deductions of *related* trades or businesses see Section 45. This must mean entities which are *related* but either are not *affiliates* under the statutory test or have not chosen to file consolidated returns. There is no room left for more allocation under Section 45 if consolidated returns are filed, as all allocation problems are comprehensively dealt with in the Consolidated Return Regulations themselves.[7] Regs. 118 § 39.45-1(b)(2) provide that if a controlled taxpayer is a party to a consolidated return, the true consolidated net income of the affiliated group is *determined consistently with the principles of a consolidated return.* The Regulations also announce that the purpose of Section 45 is to place a controlled taxpayer on a parity with an uncontrolled taxpayer. Regs. 118 § 39.45-1 (b)(1). There is no evidence here to support any conclu-

[7] *National Securities Corp. v. Com'r of Internal Revenue,* 137 F.2d 600 (3d Cir. 1943), has nothing to do with consolidated returns, none having been filed in that case.

sion that the dealings between Refiners and Hilo Gas were not fair and that the same transactions would not have been undertaken if the corporations had been independent. No valid reason exists for a reallocation under Section 45 except to prevent Refiners from securing the benefit of the net operating loss carryover. See *Virginia Metal Products, Inc.,* 33 T. C. ..... No. 88 (1960). We do not see how the Commissioner could have exercised his authority to allocate in this case. The government proposes to allocate the deduction solely to Hilo Gas, but this is no change from what the taxpayers did. The loss was reported as a Hilo Gas loss, not a Refiners loss. Further, even if the Commissioner had authority to allocate the loss to Hilo Gas under Section 45 on the ground of tax evasion or "clearly to reflect income," he never did so. (R. 47.) It is too late for the government to attempt to do so now. *Chelsea Products, Inc.,* 16 T. C. 840 (1951), *aff'd* in part 197 F.2d 620, 624 (3rd Cir. 1952); *Wilfred J. Funk,* 3 CCH *Tax Ct. Mem.* 100, 103 (1944); *Ross v. Commissioner of Internal Revenue,* 129 F.2d 310 (5th Cir. 1942).

The next suggestion is that Refiners was not the corporate entity that suffered the loss and therefore cannot claim it. (Gov. Br. 23-24.) This cannot be the rule in the case of consolidated returns as it is everywhere recognized that a principal advantage of consolidated returns is that losses of loss members of the affiliated group may be used to offset the income of *other* members of the group. Peel, *Consolidated Tax Returns* § 2.02 (Callaghan & Co. 1959). See also Opening Brief pp. 51-52. In fact, in the leading case cited by the government to support this proposition, *Lisbon Shops, Inc. v. Koehler,* 353 U.S. 382 (1956), the Supreme Court expressly recognized that if the corporations involved had chosen to file a consolidated return they could have taken the losses of three members of the group against the consolidated net income of the group as a whole, "*an opportunity that they elected to forego when*

they chose not to file a consolidated return." (p. 388) (Emphasis added.) None of the other cases cited by the government involve consolidated returns and are not in point. The maintenance of a period of affiliation during which a loss occurred was not "unreal or a mere sham" as the government suggests. Hilo Gas was an old established utility. It could not dispose of its utility assets without PUC approval. The PUC's order granting approval necessarily recognizes the separate corporate identity of Hilo Gas. (R. 53.) There was surely nothing unreal or sham about the transaction establishing the Hilo Gas loss or about its corporate entity. *Cf. Kraft Foods Company v. Commissioner of Internal Rev.,* 232 F.2d 118, 124 (2d Cir. 1956).

Finally, the government urges the applicability of the *Kimbell-Diamond* rule. (Gov. Br. 24-26.) This is going far afield. The rule is that where stock of a corporation is purchased in order to get physical assets and the purchaser then promptly liquidates the corporation and receives the assets, the separate steps will be treated as a single transaction—the purchase of property—and the purchaser's basis for the assets will be his cost of the stock. If the purchaser of the stock never receives the assets, there can be no question of his purchasing property and no basis question and thus no occasion for the operation of the rule. For example, the rule as codified in Section 334(b)(2), I.R.C. 1954, is not applicable except where property is received by a corporation in a distribution in complete liquidation of another corporation. In *United States v. Mattison,* 273 F.2d 13 (9th Cir. 1959) principally relied on by the government, Mattison wanted the operating assets of Wescott Oil Co. so he could sell them to Continental Oil Co. He bought all the stock of Wescott and promptly had the company liquidated and dissolved, transferring all its assets to him. He then immediately sold the operating assets to Continental. Since

he received assets on the liquidation, there is a situation where the rule can operate. This court held:

> "* * * The Kimbell-Diamond rule is not to be applied *unless the purpose of the transaction was to acquire the assets* of the company whose stock has been purchased. * * * Where the objective is to consummate a pre-arranged sale of the assets, the purpose to acquire is just as certainly established as where the objective is to integrate the assets into the business. In both cases *the title to the assets must be obtained* before the objective can be realized. * * *" (273 F.2d 19) (Emphasis added.)

The factual situation in the present case simply does not permit application of the *Kimbell-Diamond* rule. Refiners never acquired the utility assets of Hilo Gas; it never obtained title to these assets and never intended to. If it had acquird the Hilo Gas utility assets it would have become a regulated public utility, a situation it wanted to avoid. (R. 27-28.) Refiners' purpose was to secure a market for butane on the Island of Hawaii. It was interested in the business and customers of Hilo Gas, not its physical assets. (R. 29-34.) In fact, one of its proposals was that the Hilo Gas utility plant be scrapped altogether and gas appliances hooked up to butane tanks. (R. 31.) The appliance and liquefied petroleum gas assets which Refiners acquired from Hilo Gas were a relatively small proportion of its total assets. (R. 37-38.) Hilo Gas was not liquidated promptly, and when liquidated in 1956, the assets distributed to Refiners were not physical assets but intangibles. Hilo Gas sold its utility assets to Honolulu Gas and that company scrapped much of the Hilo Gas manufacturing plant after the conversion of the distribution system to butane air. (R. 38-39.)

Refiners could not possibly meet the two tests for the *Kimbell-Diamond* rule laid down by *Mattison*—the *purpose* of the transaction was not to acquire the physical assets of Hilo Gas and *title* to such assets was not ob-

tained by Refiners. Refiners has no *basis* problem, as suggested by the government. It never acquired the utility assets, so it can have no basis for them. Only the basis of Hilo Gas for the assets is significant, and there is no question raised about that. The loss on sale of the assets was a real loss suffered by Hilo Gas as a separate corporate entity. Hilo Gas is entitled to a deduction for this loss under Section 23(f) and Regs. 118 § 39.23(f), and Refiners is entitled to include this loss in its consolidated return.

SECOND ISSUE: HAWAII INCOME TAXES ON CAPITAL GAINS REALIZED IN 1955 ARE DEDUCTIBLE.

A. Section 265 is not applicable because non-recognized gains under Section 337 are not income "wholly exempt" from the income tax.

The government meets this point by relying on the technical argument that the corporation itself will never pay a tax on these gains, since it is to be dissolved and its existence terminated.

However, the government does not deny that the same gains will be taxed to the stockholders of the liquidated corporation—and within one year of the adoption of the plan of liquidation—if Section 337 is complied with. The fact that under Section 337 there is a tax on the *same gains* to the stockholders is amply demonstrated by the Committee Reports quoted in our opening brief. (Op. Br. 71-74.)[8]

The Internal Revenue Service has recognized that gain under Section 337 is not wholly exempt. Rev. Rul. 56-387, 1956-2 *Cum. Bull.* 189, deals with the liquidation of an

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[8]For example, the House Report states:

"* * * your committee has provided that if a corporation in process of liquidation sells assets there will be no tax at the corporate level, *but any gain realized will be taxed to the distributee-shareholder,* * * *." (Emphasis added.) H.Rep. 1337, 83d Cong., 2d Sess., 1954, pp. 38-39.

insolvent corporation. It was planned to liquidate the corporation within a twelve-month period and distribute the assets to the creditors. The Ruling held that Section 337 could not be applicable to the gain on the proposed sale since all the assets would be distributed to creditors and none to the stockholders.

> "* * * Congress intended through section 337 of the 1954 Code *to eliminate the double tax on gains realized from sales of corporate assets* during a period of liquidation, *but did not intend to eliminate entirely the tax on such gains.* Where the shareholders are to receive nothing in the liquidation in payment for their stock, there is no possibility of a tax to both the corporation and the shareholders *on the gains resulting from the sale.*" (Emphasis added.)

The fact that the gain to the stockholders may be measured by a different basis than the gain to the corporation is of no significance. The gain realized when a liquidating corporation sells assets at a profit is promptly passed on to the stockholders and becomes part of the gain which they realize and are taxed upon when they surrender their shares for redemption. The same gain is taxed to the stockholders as would be taxed to the corporation if Section 337 did not intervene, a result intended by Congress and stressed by the Internal Revenue Service in Rev. Rul. 56-387. Hence, it cannot be said that such gain is income "wholly exempt" from taxation.

The government reads Section 265 as if it referred to income "wholly exempt *to the taxpayer* from the taxes imposed by this subtitle." However, the words "to the taxpayer" are not present. In fact, the legislative history shows that the words "to the taxpayer" were first inserted and then eliminated from the section. The section involved is Section 24(a)(5), the predecessor of Section 265(1). As originally reported by the House Ways and Means Committee the section provided:

> "Any amount otherwise allowable as a deduction which is allocable to one or more classes of income

> * * * wholly exempt *to the taxpayer* from the taxes imposed by this subtitle."

The words "to the taxpayer" were eliminated from the Ways and Means Committee bill by the Senate Finance Committee. The Conference Report with respect to this change states:

> "The House bill disallowed deductions allocable to income 'wholly exempt to the taxpayer' from the taxes imposed by title I. The Senate amendment makes the disallowance of the deduction depend on whether the income is 'wholly exempt' from the taxes imposed by title I. The House recedes." Seidman's, *Legislative History of Federal Income Tax Laws, 1938-1861,* p. 315.

By eliminating the words "to the taxpayer" Congress can only have intended to make the test whether the income is *wholly exempt* from taxes, not whether it is exempt to one particular taxpayer. In other words, if it is exempt to one taxpayer but taxable to another, the test is not satisfied. This is the situation, in a nutshell, in a Section 337 liquidation.

Cotton States Fertilizer Co., 28 T. C. 1169 (1957), *acq.* 1958-1 *Cum. Bull.* 4, makes two points: first, that nonrecognized gains are not the kind of exempt income covered by Section 24(a)(5), and second, that because of the required basis adjustment the taxpayer corporation will have to pay the tax in a subsequent year *if* it sells the property at a profit. The first point is made twice, once at p. 1172 where the court says that Sections 22(b) and 116 list a great number of items which are exempt from tax and that fire insurance proceeds which are not recognized under Section 112(f) are not listed as being exempt, and once at p. 1173 where the court distinguishes cases cited by the Commissioner because they involved life insurance proceeds made wholly exempt by statute. The Tax Court is clearly of the opinion that there are three

classes of income—taxable income, exempt income and non-recognized income, and that the latter is not included under Section 24(a)(5). This first point made by the Tax Court is directly applicable here because the gain is a non-recognized gain under Section 337, not an exempt item under Section 22(b) or Section 116. With respect to the second point, the only significant difference between the involuntary conversion situation and the Section 337 liquidation situation is that in the former case the tax is indefinitely postponed (until such time as the taxpayer may sell the property at a profit), whereas in the latter case the tax on the same gain may be postponed for not more than one year and must then be paid by the corporation's stockholders. The tax on the gain is not eliminated, only the *double tax* is avoided. In view of the express recognition in the Congressional Committee Reports and in Rev. Rul. 56-387, *supra,* that Section 337 did not eliminate entirely the tax on the gains realized in a corporate liquidation, the government's attempt to distinguish *Cotton States* on the ground that the tax in a Section 337 liquidation is "wholly relieved" must fail.

The government misunderstands the reason for the citation of the cases on liquidation expenses referred to in our opening brief (Op. Br. 76). These cases are cited to show that liquidation expenses, including taxes, are allowed as deductions in a liquidation procedure utilizing the *Cumberland Public Service* route. However, under the government's argument, these liquidation expenses would *not* be allowable in a Section 337 liquidation because they would be connected with production of tax exempt income. Our point is that this is a result which Congress could not have intended because it enacted Section 337 for the specific purpose of removing the distinction between the *Court Holding Company* and *Cumberland Public Service* liquidation routes. Consequently, Congress cannot have intended to have Section 265 applied to non-recognized gains under Section 337.

B. Section 265 is not applicable because it does not reach the Hawaii income tax which is fully deductible under Section 164.

We do not suggest, as the government implies (Gov. Br. 28-29) that Section 265 is more limited than Section 24(a)(5) because of the new section heading, "Expenses." We suggest only that in the 1954 re-write of the Code Congress expressed its *original* intention with respect to the scope of this section by utilizing the heading "Expenses." Section 24(a)(5) had no heading; when the time came to give the section a heading, Congress chose an accurate one: "Expenses and Interest Relating to Tax Exempt Income." Moreover, the limitation of Section 265 to expenses is the only interpretation which is consistent with the legislative history of Section 24(a)(5). (Op. Br. 80-81.) The Committee Reports are specific to the effect that Congress intended to eliminate as deductions from gross income *expenses incurred in the production of such income.* A state income tax on the profit derived from a sale cannot be an expense incurred in the production of the income realized on the sale. Commissions, fees and other selling expenses actually have a part in producing the income itself, whereas income taxes, levied after the sale has been completed on the taxpayer's net income for the entire year, can have no part in producing the tax exempt income.

Another reason why Section 265 is not applicable is that state income taxes are not properly "allocable" to the gain realized in a Section 337 liquidation.[9] As pointed out in our opening brief (Op. Br. 84) state income taxes are not applicable to reduce gain on the sale of assets, but are an absolute independent deduction under Section

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[9]Section 265 refers to any amount otherwise allowable as a deduction which is *allocable* to a class of exempt income. The Commissioner has allocated $61,061 of the Hawaii income tax to the gain from the sale of assets (R. 51) and there is no quarrel with his mathematics. However, we submit that, as a matter of law, the Hawaii tax is not a deduction which is properly "allocable" to the gain within the meaning of Section 265. *Cf. Carstairs v. United States,* 75 F.Supp. 683, 685 (E.D. Pa. 1936).

164. Section 337 provides for non-recognition of "gain" from the sale of property. "Gain" is determined under Section 1001, and it is there provided that gain is the excess of the amount realized from the sale over the adjusted basis. Adjusted basis is determined under Section 1016, and under this section it is clear that income taxes are not a deduction to be made in computing adjusted basis. See Regs. 1.1016-2(c), last sentence. Since the gain which is the subject of Section 337 is computed entirely without reference to the state income tax, the state tax cannot be "allocable" to the gain within the meaning of Section 265. Allocating the state tax to the gain after it has been computed under Sections 1001 and 1016 has the effect of recomputing the gain in a manner forbidden by the statute.[10] State income taxes have no relationship to the production of income or the obtaining of a capital gain but are tax exactions for the support of the state government levied on the results of all transactions which occur during a fiscal period, after such period has terminated.

Consequently, a state income tax is not within the scope of Section 265 because it is not an expense incurred in the production of income and because it is not properly allocable to the gain from the sale of property.

Dated, Honolulu, Hawaii,
October 31, 1960.

Respectfully submitted,
MARSHALL M. GOODSILL,
Attorney for Appellant.

ANDERSON, WRENN & JENKS,
Of Counsel.

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[10]It has never been held that state income taxes are allocable to a capital gain realized on the sale of property. The cases cited by the government on allocation of state taxes to exempt income (Gov. Br. 28) are not in point here because they relate to income taxes on exempt compensation, not to gains from the sale of property.

No. 16859

United States
Court of Appeals
for the Ninth Circuit

HAWAIIAN TRUST COMPANY, LIMITED, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Hawaii

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-10-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

For the Plaintiff, Hawaiian Trust Company, Limited:

ANDERSON, WRENN & JENKS, by
MARSHALL M. GOODSILL, ESQ.,
Bank of Hawaii Building,
Honolulu, Hawaii.

For the Defendant, United States of America:

LOUIS B. BLISSARD, ESQ.,
United States Attorney,
Federal Building,
Honolulu, Hawaii.

United States District Court for the
District of Hawaii

Civil Action No. 1619

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Hawaiian Trust Company, Limited, a Hawaii corporation, Trustee for the creditors and stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation, brings this suit against the United States of America and claims and alleges:

I.

This is a civil action by a corporation incorporated under the laws of the Territory of Hawaii and doing business in the Territory of Hawaii against the United States for recovery of Internal Revenue taxes and interest erroneously and illegally assessed and collected, of which this court has jurisdiction, regardless of the sum involved, under Title 28, U. S. Code, Sections 1340 and 1346.

II.

Plaintiff has complied with the requirements of

Sections 6532(a) and 7422(a) of the Internal Revenue Code of 1954 (and the predecessor sections of the 1939 Code) regarding suits for recovery of any Internal Revenue tax, penalty or other sum, as hereafter more fully appears.

III.

Plaintiff's claim is for the recovery of $109,-692.18 in principal amount of income taxes illegally and erroneously assessed and collected from plaintiff for the taxable years 1953 and 1955, plus $15,055.76 interest paid thereon, or a total of $124,-747.94. In addition, plaintiff is entitled to interest on the entire amount of principal and interest paid, as provided by law. The amounts of the overassessments and overpayments for each year are as follows:

Year	Principal	Interest	Total
1953	$ 58,472.39	$11,301.99	$ 69,774.38
1955	51,219.79	3,753.77	54,973.56
	$109,692.18	$15,055.76	$124,747.94

IV.

The facts upon which plaintiff's claim for the year 1953 is based are as follows:

(a) Pacific Refiners, Limited (hereinafter called Refiners) was organized as a corporation under the laws of the Territory of Hawaii on May 31, 1949. It was dissolved on November 19, 1956, and Hawaiian Trust Company, Limited, was appointed trustee for the creditors and stockholders. Refiners' taxable year was the calendar year.

(b) Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in the Territory of Hawaii. Refiners entered into an oil and butane contract with Standard Oil of California in August, 1949, for a period of ten years for the purchase of petroleum oil and butane. The butane was blended by Standard Oil Company of California into heavy gas oil and shipped to Refiners in Honolulu. Refiners at its refinery in Honolulu separated the butane from the gas oil. The butane thus obtained was liquefied and stored by Refiners in pressure tanks, ready for distribution and sale. The butane-free gas oil was then passed through a further process which removed diesel oil and similar fractions contained in the original oil, leaving asphalt. The gas oil was then sold to Honolulu Gas Company, Limited, for its use in the manufacture of gas. Under this contract with Standard Oil Company, Refiners was required to purchase a substantial minimum amount of heavy gas oil blended with butane. Refiners was not a public utility, and its buatne business was not subject to regulation by the Territorial Public Utilities Commission.

(c) Hilo Gas Company, Limited, was organized in 1927 as a public utility company to manufacture gas from oil and distribute it through gas mains in the city of Hilo. It had encountered financial difficulties, and in the spring of 1950 entered into negotiations with Refiners. The proposition was made

that Hilo Gas Company cease the manufacture of gas and buy butane from Refiners, which the Hilo Gas Company would then distribute through its gas mains in the city of Hilo as a public utility. This would save manufacturing cost and reduce gas rates to a point where they might be competitive with electric rates. The negotiations failed, but in September, 1950, the two principal stockholders of Hilo Gas Company offered to sell their stock. Refiners was interested, because the acquisition of the Hilo Gas Company would provide an assured outlet for butane on the island of Hawaii. In view of Refiners' commitment to Standard Oil Company to purchase minimum amounts of butane, and in view of the fact that Refiners' new refinery was to be completed in December of 1950, it became imperative to Refiners to find outlets for its butane production as quickly as possible in order to comply with the terms of its contract with Standard Oil. Therefore, on October 3, 1950, an option was obtained by Refiners from Mr. Lyman (president of the Hilo Gas) granting to Refiners a seven-day option to purchase his shares (subject to the condition that the purchaser obtain options to purchase not less than 75% of each of the outstanding classes of stock of Hilo Gas Company). On the same date Refiners obtained a similar option from Mr. Hutchinson, the other principal stockholder.

(d) On October 5, 1950, the Board of Directors of Refiners authorized the purchase of the Hilo Gas Compnay stock. Hilo Gas Company had two classes

of capital stock outstanding—8% first preferred and 7% second preferred. Both classes had voting rights.

(e) The stock of Messrs. Lyman and Hutchinson was sold to Refiners on October 6, 1950. At about the same time Refiners also purchased the largest blocks of stock held by other stockholders. On October 21, 1950, a letter was sent to the remaining stockholders of Hilo Gas Company offering to purchase their shares at the same price, and pursuant to this offer, Refiners purchased before October 25 most of the outstanding shares of both classes held by minority stockholders. Prior to October 25, 1950, Refiners had ecquired 95% or more of the outstanding capital stock of Hilo Gas Company. On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas Company had been acquired.

(f) On October 20, 1950, Hilo Gas Company, Limited, filed a petition with the Public Utilties Commission for authority to sell its utility assets to Honolulu Gas Company, Limited. A hearing on this application was held on October 26, 1950, and the Commission issued an order dated October, 26, 1950, which was filed on November 15, 1950, authorizing the Hilo Gas Company to sell its utility assets to Honolulu Gas Company.

(g) On October 31, 1950, the stockholders of Hilo Gas Company authorized the sale of the utility assets of the company to Honolulu Gas Company

and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas Company, Limited, executed a bill of sale transferring to Refiners the merchandise and liquefied petroleum gas business. On the same date, Hilo Gas Company and Honolulu Gas Company, Limited, executed an instrument whereby the Hilo Gas Company conveyed to the Honolulu Gas Company its utility plant and equipment, etc., and the Honolulu Gas Company assumed the liabilities of the Hilo Gas Company. Possession of these assets was not taken by the purchasers until after October 31, 1950.

(h) After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas Company to Honolulu Gas Company, Limited, the necessary facilities for converting the Hilo system to butane air were ordered. The conversion of the system was completed in March of 1951, and on April 1, 1951, butane air gas was first supplied to the city of Hilo. Until April 1, 1951, all of the gas furnished to the city of Hilo was manufactured in the old plant of Hilo Gas Company. The old plant was retained as a stand-by facility for a month or so after April 1, 1951, until it could be ascertained that the butane air system was operating properly. Thereafter, such of the manufacturing facilities of the old plant as were not used in the butane air system were abandoned, scrapped or transferred to the Honolulu division of the Honolulu Gas Company, Limited.

(i) Hilo Gas Company suffered a net loss of $122,930.58 on the sale of its utility assets and franchise to Honolulu Gas Company, Limited. The net loss of Hilo Gas Company for 1950 was $117,792.57.

(j) Refiners and Hilo Gas Company filed consolidated federal income tax returns for the years 1950-1953, inclusive. They filed separate returns for the years 1954 and 1955. Hilo Gas Company, Limited, filed separate Territorial income tax returns for the years 1950-1955, inclusive.

(k) Hilo Gas Company filed annual corporate exhibits required by Territorial law for the years 1950-1955. In 1951 it reported in this corporate exhibit total income of $19,294.16, total expenses of $18,324.96 and a net income (before taxes) of $969.20. In 1952, it reported a total income of $10,732, total expenses of $10,273 and a net income (before taxes) of $459. In 1953, it reported a total income of $8,600, total expenses of $5,830.71 and a net income (before taxes) of $2,769.29. In 1954, it reported total income of $8,600, total expenses of $6,009 and net income (before taxes) of $2,590. In 1955, it reported total income of $8,700, total expenses of $6,063 and net income (before taxes) of $2,636. Hilo Gas Company was dissolved effective September 18, 1956.

(l) In the year 1950, Refiners suffered a loss of $93,092. In 1951, it had a net income of $17,445 and in 1952 a net income of $39,147. It did not have to pay any net income taxes for those years. In 1953, Refiners had a net income (before net income

taxes) of $206,397.20, and in 1954, it had a net income (before net income taxes) of $215,735.66. All of the foregoing figures are on an unconsolidated basis.

(m) Refiners included the net loss from the sale in 1950 of the operating assets and franchise of the Hilo Gas Company, Limited, in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas Company. The Commissioner of Internal Revenue has disallowed this item. The explanation given in the statement attached to the 150-day letter of the Appellate Division dated May 15, 1957, is as follows:

"On your return for the calendar year 1953, you claimed a net operating loss deduction of $145,-325.46. Included in this figure is an amount of $116,405.64 allegedly representing a net loss carry-over of Hilo Gas Company, Ltd., originating in the year 1950, computed as follows:

Purported loss from sale of utility assets to Honolulu Gas Company, Ltd., on October 31, 1950..		$122,930.58
Less:		
Net operating profit—Hilo Gas Company, Ltd.—1950.....	$5,138.01	
Net operating profit—Hilo Gas Company, Ltd.—1951.....	969.20	
Net operating profit—Hilo Gas Company, Ltd.—1952.....	417.73	6,524.94
Net operating loss carry-over claimed as deduction in 1953.....		$116,405.64

Affiliation with Hilo Gas Company, Ltd., occurred some time in October, 1950.

"It is held that, in substance, no deductible loss was sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in 1950. In the event that a loss was sustained as a result of this transaction, it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. Accordingly, the net loss, if any, sutained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is therefore, disallowed."

(n) On June 4, 1957, Hawaiian Trust Company, Limited, as trustee in dissolution of Refiners, paid a deficiency of $58,472.39, together with interest of $11,301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas Company in 1950 upon the sale of the utility assets to Honolulu Gas Company,

Limited. Said payment was made to the District Director of Internal Revenue in Honolulu.

(o) Plaintiff alleges that all of the foregoing sums were erroneously paid and illegally assessed and collected.

(p) On August 28, 1957, plaintiff, as trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1953 covering said principal amount of $58,472.39 and said payment of interest of $11,301.99. A true copy of said Claim for Refund is attached hereto, marked Exhibit A and by reference made a part hereof. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954 and its predecessor sections of the Internal Revenue Code of 1939. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

(q) On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $69,774.38 for the year 1953 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 3772(a), Internal Revenue Code of 1939. A true copy of said Notice of Disallowance is attached hereto, marked Exhibit B and by reference made a part hereof.

V.

The Commissioner's action in disallowing the 1950 net operating loss carry-over and in assessing

and collecting said deficiency and interest for 1953 was erroneous and illegal for the following reasons:

(a) Section 141(a), Internal Revenue Code of 1939, extends to an affiliated group of corporations the privilege of making a consolidated return. Section 141(d) defines an affiliated group as one or more chains of includible corporations connected through stock ownership (95%) with a common parent corporation. Section 141(e) defines an includible corporation as any corporation except an exempt corporation and others, none of which exemptions or exceptions are applicable here. Refiners and Hilo Gas Company became affiliated corporations prior to October 25, 1950, and met the statutory requirements for filing consolidated returns. Regulation 129, Section 24.11(c) provides that an affiliated group remains in existence as long as there is a common parent and at least one subsidiary remains affiliated with it. Accordingly, the affiliated group in this case remained in existence until Hilo Gas Company was dissolved in September, 1956.

(b) A loss of $122,930.58 was sustained by Hilo Gas Company on the sale of its utility assets to Honolulu Gas Company, Limited, on October 31, 1950. This loss took place on that date and not at any other time. This loss took place after affiliation with Refiners. The loss was an ordinary loss. Consequently, under the Code (Sections 23(f), 117(j), 122 and 141 of the Internal Revenue Code of 1939), the income tax regulations and the consolidated return regulations, Hilo Gas Company was entitled

to a deduction for this loss, and Refiners was entitled to include this loss in its consolidated net operating loss for 1950 and to carry it forward in full as a consolidated net operating loss carry-over to 1953.

VI.

No amount has been paid or refunded to plaintiff on account of said sums of $58,472.39 (principal) and $11,301.99 (interest) claimed as income tax and interest by defendant for the taxable year 1953 and erroneously and illegally assessed and collected by defendant from plaintiff.

VII.

The facts upon which plaintiff's claim for the year 1955 is based are as follows:

(a) The stockholders of Refiners on November 25, 1955, adopted a plan of complete liquidation providing for the sale of Refiners' refinery and related assets to Standard Oil Company of California and the sale of the Isle Gas business and related assets to Honolulu Gas Company, Limited, and thereafter the winding up of Refiners' business and the distribution of its assets and the dissolution of the corporation. In its tax return for the year 1955, Refiners claimed a deduction for organization expenses of $43,163.48. Included therein was the amount of $30,678.62 relating to expenses in connection with the issue of capital stock. These expenses are made up as follows:

Expenses of stock issue, date of offer May 8, 1950	$ 9,830.48	
Less: Federal stamp taxes	570.74	$ 9,259.74
Expenses of stock issue, date of offer April 29, 1951	22,243.99	
Less: Federal stamp taxes	825.11	21,418.88
Total expenses of marketing stock..		$30,678.62

With respect to this item, the statement attached to the Appellate Division 150-day letter dated May 15, 1957, states:

"It is held that these expenses incurred in marketing your capital stock do not constitute organization expenses but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital. The deduction of $30,678.62 claimed is, therefore, disallowed."

(b) Refiners in its 1955 income tax return claimed a deduction for accrued Territorial net income taxes of $67,648.77, based on the net income reportable for Territorial net income tax purposes, which income included (1) the gain from the sale of refinery facilities and related assets to Standard Oil Company of California and (2) the gain from the sale of the Isle Gas business and related assets to Honolulu Gas Company, Limited, in December, 1955.

(c) The total Territorial income tax paid by Refiners for the calendar year 1955 was $74,408.15, of which $59,089.97 was paid at the time of filing its return and $15,318.18 was paid in 1956 as the

result of a deficiency assessed by the Territorial Tax Collector in that year.

(d) Under the provisions of Section 337, Internal Revenue Code of 1954, no gain for Federal income tax purposes was recognized to Refiners from the sale of said assets.

(e) The Commissioner has disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets under the provisions of Section 265 of the Internal Revenue Code of 1954, stating in his 150-day letter that said section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total Territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for federal income tax purposes, was $61,061.59.

(f) On June 4, 1957, Hawaiian Trust Company, Limited, as trustee in dissolution of Refiners, paid a deficiency of $51,468.20, together with interest of $3,771.98 assessed against Refiners by the Commissioner for 1955, principally because of his disallowance of the capital stock expenses ($30,678.62) and his disallowance of 1955 Territorial income taxes ($61,061.59), as set forth above. Said payment was made to the District Director of Internal Revenue in Honolulu.

(g) Plaintiff alleges that the sum of $51,219.79 plus interest of $3,753.77 was erroneously paid and illegally assessed and collected.

(h) On August 28, 1957, plaintiff, as trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1955 in the amount of $51,219.79 plus interest of $3,753.77, or a total of $54,973.56. A true copy of said Claim for Refund is attached hereto, marked Exhibit C and by reference made a part hereof. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

(i) On October 23, 1957, a Notice of Disallowance in full of plaintiff's claim for refund of $54,973.56 for the year 1955 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 6532 (a)(1), Internal Revenue Code of 1954. A true copy of said Notice of Disallowance is attached hereto, marked Exhibit D and by reference made a part hereof.

VIII.

The Commissioner's action in disallowing the capital stock expense as a deduction and in disallowing any portion of the 1955 Territorial income taxes as a deduction and in assessing and collecting said deficiency and interest for 1955 to the extent of $54,973.56 was erroneous and illegal for the following reasons:

(a) The capital stock expenditures in question were made at about the time of the completion of Refiners' refinery and were made for the purpose of raising working capital. They are in the nature of or are similar to initial organization expenses, and as such should be allowed as deductions in the year Refiners resolved to cease business or, in any event, in the year of its dissolution. Such expenses are just as essential to the successful operation of a corporation as the expenses incurred in obtaining a corporate charter, for without capital, the charter itself is valueless. These latter expenses are deductible in full in the year of liquidation or dissolution, and the same treatment should be afforded to these capital stock expenditures.

(b) Capital gains not recognized because of the provisions of Section 337, Internal Revenue Code, do not constitute income "wholly exempt from taxes" within the meaning of Section 265(1). Consequently, the Territorial income tax on such gains is deductible in full under Section 164, and the total Territorial income tax for 1955 of $74,408.15 should have been allowed as a deduction by the Commissioner.

IX.

No amount has been paid or refunded to plaintiff of said sums of $51,219.79 (principal) and $3,753.77 (interest) claimed as income tax and interest by defendant for the taxable year 1955 and erroneously and illegally assessed and collected by defendant from plaintiff.

X.

Plaintiff is justly entitled to recover from defendant said total sum of $109,692.18 (principal) and $15,055.76 (interest) plus interest on the entire amount of principal and interest paid, as provided by law. Plaintiff has observed and performed the provisions and requirements of the laws of the United States, and the rules and regulations prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, and all other matters and things necessary to be observed and performed on its part, to entitle it to recovery of said sums.

Wherefore, plaintiff prays judgment against defendant in the sum of $124,747.94, together with interest as in such cases is provided by law, and the costs of this suit, and that process issue out of this court requiring defendant to appear and answer this Complaint.

Dated at Honolulu, Hawaii, this 28th day of January, 1958.

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

ANDERSON, WRENN &
JENKS,
Of Counsel.

[Endorsed]: Filed January 28, 1958.

[Title of District Court and Cause.]

ANSWER

Now comes the United States of America, the above-named defendant, by its attorney, Louis B. Blissard, United States Attorney in and for the District of Hawaii, and for its answer to the complaint filed herein alleges and says:

1.

Admits the allegations contained in paragraph numbered I thereof, except that it is denied that the taxes and interest sought to be recovered in this action were erroneously and illegally assessed and collected, as alleged in said paragraph.

2.

Admits the allegations contained in paragraph numbered II thereof.

3.

Admits the allegations contained in paragraph numbered III thereof, except that it is denied that the income taxes sought to be recovered herein were illegally and erroneously assessed and collected from plaintiff, and except that it is denied that there were overassessments and overpayments by plaintiff for the years 1953 and 1955, as alleged in said paragraph.

4.

Answering paragraph numbered IV thereof, the defendant alleges as follows:

(a) Admits the allegations contained in subparagraph (a) thereof.

(b) The defendant is presently without knowledge or sufficient information with respect to the truth of the allegations contained in subparagraphs (b), (c), (d), (e), (f), (g) and (h) thereof.

(c) Denies the allegations contained in subparagraph (i) thereof.

(d) Admits that Refiners and Hilo Gas Company filed returns purporting to be consolidated Federal income tax returns for the years 1950 to 1953, inclusive, as alleged in subparagraph (j) thereof, except that it is denied that said companies had the right to file consolidated returns for those years. Further answering said subparagraph, the defendant admits that separate Federal income tax returns were filed by Refiners and Hilo Gas Company for the years 1954 and 1955. The defendant has no present knowledge or sufficient information as to whether Hilo Gas Company filed separate Territorial income tax returns for the years 1950 to 1955, inclusive, as alleged in said subparagraph.

(e) The defendant has no present knowledge or sufficient information as to the truth of the allegations contained in subparagraph (k) thereof.

(f) Admits the allegations contained in subparagraph (l) thereof, except that the defendant is at present without knowledge or information as to the correct amount of loss suffered by Refiners in the year 1950, nor the correct amount of taxable

income of Refiners for the years 1951, 1953 and 1954, as alleged in said subparagraph.

(g) Admits the allegations contained in subparagraph (m) thereof, except that it is denied that there was a loss allowable or deductible resulting from the sale in 1950 of the operating assets and franchise of Hilo Gas Company, Ltd.

(h) Admits the allegations contained in subparagraph (n) thereof.

(i) Denies the allegations contained in subparagraph (o) thereof.

(j) Admits the allegations contained in subparagraph (p) thereof, except that the allegations contained in the claim for refund, copy of which is attached to the complaint as Exhibit A, are denied.

(k) Admits the allegations contained in subparagraph (q) thereof.

5.

Denies the allegations contained in paragraph numbered V thereof, except that the allegations contained in subparagraph (a) therof are admitted, with the exception that it is denied that Refiners and Hilo Gas Company were affiliated corporations prior to October 25, 1950, or at any other time, and met the statutory requirements for filing consolidated returns, as alleged in said subparagraph, and except that the allegations contained in subparagraph (b) thereof are denied.

6.

Admits the allegations contained in paragraph numbered VI thereof, except that it is denied that the income tax and interest referred to in said paragraph were erroneously and illegally assessed and collected by the defendant from plaintiff.

7.

Answering paragraph numbered VII thereof, the defendant alleges as follows:

(a) Admits the allegations contained in subparagraph (a) thereof, except that the defendant is at present without knowledge or sufficient information as to the truth of the allegations contained in the first sentence of said subparagraph.

(b) Admits the allegations contained in subparagraphs (b), (c), (d) and (e) thereof.

(c) Admits the allegations contained in subparagraph (f) thereof, except that $35,670.31 of the deficiency of $51,468.20, plus interest of $3,850.90, instead of $3,771.98, assessed against plaintiff was paid on June 4, 1957, that $1,560.73 of said assessment was paid on July 26, 1957, and that the balance of $18,088.13 was satisfied by credit on July 24, 1957.

(d) Denies the allegations contained in subparagraph (g) thereof.

(e) Admits the allegations contained in subparagraph (h) thereof, except that the allegations contained in the claim for refund, attached to the complaint as Scedule C, are denied.

(f) Admits the allegations contained in subparagraph (i) thereof.

8.

Denies the allegations contained in paragraph numbered VIII and subparagraphs (a) and (b) thereof.

9.

Admits the allegations contained in paragraph numbered IX thereof, except that the defendant denies that the income tax and interest referred to in said paragraph was erroneously and illegally assessed and collected by defendant from plaintiff.

10.

Denies the allegations contained in paragraph numbered X thereof.

Wherefore, defendant prays that the complaint filed herein be dismissed, with costs to be assessed against the plaintiff.

/s/ E. C. CRUMPACKER,
Asst. United States Attorney,
Attorney for Defendant.

Receipt of copy acknowledged.

[Endorsed]: Filed March 27, 1958.

[Title of District Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that the following statements of fact shall be considered as true and in evidence. It is also agreed by and between the parties hereto that they may also offer any other evidence, oral, documentary or otherwise, in the trial of this case, provided such additional evidence shall not vary or in any way contradict with the statements heretofore taken to be true, and provided further that such additional evidence is properly admissible.

I.

Pacific Refiners, Limited (hereinafter called Refiners) was organized as a corporation under the laws of the Territory of Hawaii on May 31, 1949. Refiners was dissolved on November 19, 1956, and Hawaiian Trust Company, Limited (hereinafter called the plaintiff), was appointed Trustee for the creditors and stockholders in accordance with the laws of the Territory of Hawaii.

II.

Refiners had an initial authorized capital of $250,000 represented by 250,000 shares of common stock of the par value of $1.00 per share. Honolulu Gas Company, Limited (hereinafter called Honolulu Gas), a Hawaii public utility corporation, operating

a manufactured gas business on the Island of Oahu, purchased at par the initial 250,000 shares of common stock of Refiners, and in August of 1949, distributed such stock as a dividend to the stockholders of Honolulu Gas. After its organization, Refiners engaged in the merchandising of gas appliances and commenced construction of its refinery. In order to pay for construction expenditures, it borrowed $650,000 on short-term promissory notes. In May of 1950, Refiners sold to the public (through a rights offering) an additional 500,000 shares of common stock and $750,000 principal amount of fifteen-year, 6% sinking fund debentures. The net proceeds of this issue were estimated at $1,225,445. Refiners' prospectus relating to this issue stated with respect to the application of the proceeds from the offering:

"Of such net proceeds, $650,000 will be applied to pay $650,000 principal amount of the Company's short-term promissory notes * * *. The balance of such net proceeds will be added to the general funds of the Company and will be available for the payment of capital expenditures during 1950, the reimbursement of the Company for construction expenditures already made, or for other corporate purposes."

In this connection with this offering, Refiners incurred expenditures attributable to the issuance of its shares of common stock (principally attorneys' fees, printing expenses, accountants' fees and charges of the stock subscription agent) in the amount of $9,259.74. In December of 1950, Refiners

completed the construction of its refinery at a cost somewhat in excess of its estimate. In April of 1951, Refiners sold an additional 750,000 shares of common stock to the public (through a rights offering). The net proceeds from this issue were estimated at $734,400. In respect to such proceeds, the prospectus stated:

> "$600,000 of such proceeds will be applied to pay a like face amount of the Company's short-term promissory notes. These notes or other notes refunded by them represent moneys borrowed to pay for construction expenditures and to carry inventories and receivables or to replace treasury funds previously expended for such purpose. The balance of such proceeds will be added to the general funds of the Company and will be available for the reimbursement of the Company for construction expenditures previously made or for other corporate purposes."

In connection with this issue, Refiners incurred capital stock expenses (principally attorneys' fees, printing expenses, accountants' fees and charges of the stock subscription agent) in the amount of $21,418.88.

III.

Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in the Territory of Hawaii. Refiners was not a public utility, and none of its business was subject to

regulation by the Public Utilities Commission of the Territory of Hawaii. Refiners entered into an oil and butane contract with Standard Oil of California (hereinafter called Standard) in August of 1949 for a period of ten years for the purchase of petroleum oil and butane. The butane was blended by Standard into heavy gas oil and shipped to Refiners in Honolulu. Refiners at its refinery in Honolulu separated the butane from the gas oil. The butane thus obtained was liquefied and stored by Refiners in pressure tanks, ready for distribution and sale. The butane-free gas oil was then passed through a further process which removed diesel oil and similar fractions contained in the original oil, leaving asphalt. The gas oil was then sold to Honolulu Gas for its use in the manufacture of gas. Under this contract with Standard, Refiners was required to purchase a substantial minimum amount of heavy gas oil blended with butane. For the first contract year the minimum amounts were 450,000 barrels of oil and 650,000 gallons of butane; for the second year the minimum amounts were 500,000 barrels of oil and 1,450,000 gallons of butane; for each contract year thereafter the minimum amounts were 500,000 barrels of oil and 1,700,000 gallons of butane. The Hilo Gas Company, Limited (hereinafter called Hilo Gas), distribution system, after its conversion to butane air in 1951, used in excess of 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners.

IV.

Hilo Gas was organized as a corporation under the laws of the Territory of Hawaii in 1927. It engaged in the business of manufacturing gas from oil and distributing it through gas mains in the City of Hilo. It was a public utility subject to regulation by the Public Utilities Commission. In 1948 and 1949 the company lost money and was in financial difficulty. In the spring of 1950, Mr. A. E. Englebright, who was then the general manager of Refiners, was approached by Mr. Orlando Lyman, the president and the largest stockholder of Hilo Gas, for assistance in solving the problems of Hilo Gas. The proposition was made that Hilo Gas cease the manufacture of gas from oil and buy butane from Refiners, which Hilo Gas would then distribute through its gas mains in the City of Hilo as a public utility. This would save manufacturing costs and reduce gas rates to a point where they might be competitive with electric rates. The minutes of the Executive Committee of Refiners for May 10, 1950, state:

> "The General Manager and the Secretary reviewed the findings of their recent trip to Hawaii taken for the purpose of determining the best outlet for butane on that island. It was reported that the Hilo Gas Company wished to enter into an arrangement whereby they would convert their manufactured gas facilities to a butane-air or butane-vapor operation and that, in conjunction with this, they wished to obtain

a franchise for the distribution of butane throughout the entire Island of Hawaii."

The feasability of the Hilo Gas plan depended to some extent on the condition of its gas mains. Mr. Englebright sent Mr. L. L. Gowans, chief engineer of Honolulu Gas, to Hilo to make a survey. Mr. Gowans made a report, dated June 14, 1950, which concluded that the gas mains were in adequate condition and that it would be entirely feasible and desirable to distribute a butane air mix in the Hilo Gas distribution system without too great a loss in leakage. After these reports and conversations with the principals, Refiners, on August 7, 1950, made a proposal to Mr. Lyman that it supply Hilo Gas with butane at 16c per gallon, based on the present posted price of butane in San Francisco. Refiners would also provide equipment and appurtenances for butane air installation at the Hilo plant at a cost of approximately $25,000, to be repaid by Hilo Gas through an additional 1c per gallon payment for all butane used in its system. Mr. Lyman expressed interest in this proposal, but in addition wished to acquire the franchise for distribution of "Isle-Gas" (Refiners' trade name for butane which it distributed in tanks or containers for use by rural customers) throughout the Island of Hawaii at the price quoted for use in the Hilo Gas mains. On August 31, 1950, Mr. Englebright wrote Mr. Lyman that Refiners could not go along with his proposal to include the North Hilo and Puna districts with Hilo proper for a combination utility and non-

utility operation, with butane to be supplied at the price which Refiners had proposed for Hilo Gas only. He said that Refiners was prepared to go ahead with the conversion proposal stated in the letter of August 7, but that it could not guarantee that Isle-Gas installations (which would be handled by other parties) would not compete directly with Hilo Gas service. This might be serious, said Mr. Englebright, as the cooking load (the only profitable load of Hilo Gas) could be served more cheaply with Isle-Gas than with gas from the mains of Hilo Gas. Mr. Englebright suggested that it might be wisest for Hilo Gas to discontinue operations as a public utility (that is, distribution of gas through city gas mains) and instead convert all appliances of its customers to a butane-vapor operation, hooking them up to butane tanks (Isle-Gas). He said that he thought that this would cost about $125,000, but would be a successful operation. This alternative proposal was not acceptable to Mr. Lyman. However, about the middle of September, 1950, Mr. Lyman offered to sell his stock in Hilo Gas to Refiners or to Honolulu Gas. With the exception of the foregoing negotiations with Refiners, neither Mr. Lyman nor any other of the stockholders or management of Hilo Gas had any plans for renovation or conversion of the Hilo Gas system or the abandonment or scrapping of the manufactured gas plant.

V.

On September 16, 1950, the Executive Committee

of Refiners met to consider Mr. Lyman's proposal. The minutes of this meeting state:

> "The manager stated that we had been approached by the majority stockholder [Mr. Lyman] of the Hilo Gas Company with the proposal that he dispose to us his holdings of that company, at a price that appeared to be advantageous from our standpoint. Another stockholder [Mr. Hutchinson] has slightly less than 30% of the balance of shares of Hilo Gas Company and it seems likely that they could be obtained for a reasonable price. Together the two holdings would more than exceed the 75% required to liquidate the corporation."

Mr. Englebright reviewed the advantages of the purchase of the Hilo Gas stock to provide an assured outlet for butane on the Island of Hawaii. He stated that in view of Refiners' commitment to Standard to purchase minimum amounts of butane, it was necessary or highly desirable to obtain this Hilo outlet, plus the non-utility business of Hilo Gas—the distribution of liquefied petroleum gas (called "Rock Gas") in tanks to rural customers beyond the city gas mains. Also, Refiners' new refinery was scheduled for completion in the fall of 1950 (actually completed in December), and it was necessary to find outlets for its butane production. Mr. Englebright stated that unless an attempt was made to perpetuate Hilo Gas, it would probably be dissolved (particularly as certain of its stockholders

were also interested in the Hilo Electric Company), and this would serve as an obstacle to expanding gas sales, not only in Hilo, but also in other parts of the Island of Hawaii. Purchase of the stock would also assure Refiners of control of the non-utility ("Rock Gas"*) business of Hilo Gas in the outlying districts of the Island of Hawaii. Another meeting of the Executive Committee of Refiners was held on September 26, 1950, at which the Hilo Gas situation was discussed. On September 27, 1950, at a meeting of the Board of Directors of Honolulu Gas, management presented a plan for the purchase of the utility assets of Hilo Gas. At this meeting a motion was adopted authorizing the acquisition of the assets of Hilo Gas at a price not to exceed $75,000, subject to the approval of the Public Utilities Commission. On October 3, 1950, an option was obtained by Refiners from Mr. Lyman granting to Refiners an option to purchase his shares for $35,000 for a period of seven days from the date of the option, subject to the condition that the purchaser obtain options to purchase not less than 75% of each of the outstanding classes of stock of Hilo Gas. There were 2,283 shares of 8% preferred stock, 1,929 shares of 7% preferred stock and no common stock outstanding. Both the 8% preferred stock and the 7% preferred stock were voting shares. Mr. Lyman owned 1,431 shares of the 8% preferred

*"Rock Gas" was the trade name for the liquefied petroleum gas distributed by Hilo Gas. It was substantially similar to and competitive with Refiners' product known as "Isle Gas."

stock and 865 shares of the 7% preferred stock. Also on October 3, 1950, Refiners obtained a similar option from Mr. Hutchinson, who owned 747 shares of 8% preferred stock and 492 shares of 7% preferred stock, for a price of $18,832.80. On October 5, 1950, the Board of Directors of Refiners authorized the purchase by it of all of the stock of Hilo Gas.

VI.

The Hilo Gas stock was purchased by Refiners, rather than by Honolulu Gas, because Refiners, as the distributor of butane, had the primary interest in securing the Hilo market. On August 31, 1950, Mr. Englebright had recommended to Mr. Lyman that, as other solutions had failed, Hilo Gas should discontinue the distribution of gas through mains and distribute butane in tanks to customers. This would have resulted in a non-utility business of no interest to Honolulu Gas, but would have left Hilo Gas as a large butane customer of Refiners. Also, Refiners wished to acquire the non-utility "Rock Gas" business of Hilo Gas in outlying districts on the Island of Hawaii. Another reason for the purchase of the stock by Refiners, rather than by Honolulu Gas, was that an order of the Public Utilities Commission would have been necessary before Honolulu Gas could act to purchase the stock, whereas no such order was required in the case of Refiners, which was not a public utility, and it was the view of the management of Refiners that quick action was necessary. Further, the purchase of Hilo

Gas stock by Honolulu Gas would have made the latter company a public utility holding company under federal law, a situation which Honolulu Gas wished to avoid.

VII.

The stock of Messrs. Lyman and Hutchinson was sold to Refiners on October 6, 1950. At about the same time Refiners also purchased the largest blocks of stock held by other stockholders. On October 21, 1950, a letter was sent to the remaining stockholders of Hilo Gas offering to purchase their shares at the same price, and pursuant to this offer, Refiners purchased before October 25 most of the outstanding shares of both classes held by minority stockholders. Prior to October 25, 1950, Refiners had acquired 95% or more of the outstanding capital stock of Hilo Gas. On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas had been acquired by Refiners—all but 164 shares. At a hearing before the Public Utilities Commisison on October 26, 1950, Mr. K. A. Conningham, Assistant Treasurer of Refiners, testified that Refiners had purchased approximately 95% of the capital stock of Hilo Gas from various stockholders and that the acquisition was completed "about ten days ago." Refiners never acquired more than 1,872 of the 1,929 outstanding shares of the 7% preferred stock of Hilo Gas and did not acquire the last minority-owned share of the 8% preferred stock until shortly before the dissolution of Hilo Gas in September, 1956. The total cost

to Refiners of the Hilo Gas stock purchased by it was $63,897.20.

VIII.

Under the Hawaii law, no public utility may sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its road, line, plant system or other property necessary or useful in the performance of its duties to the public without first having secured from the Public Utilities Commission an order authorizing it to do so, and every such sale, lease, assignment, mortgage, disposition or encumbrance made other than in accordance with the order of the Commission shall be void (§104-18, RLH 1955). On October 20, 1950, Hilo Gas filed a petition with the Public Utilities Commission in which it recited that it proposed to sell all of its assets, except its merchandise, goods, notes and accounts receivable related to the appliance sales business and its liquefied petroleum gas business, to Honolulu Gas for approximately $60,000, the exact price to be determined at its meeting of stockholders called to approve of such sale. The hearing on this application was held on October 26, 1950, at which the applicant presented its case. The Commission issued an order dated October 26, 1950, which was filed November 15, 1950, authorizing Hilo Gas to sell its utility assets to Honolulu Gas for a total consideration of approximately $64,000, consisting of a cash payment of approximately $46,000 and the assumption by the purchaser of outstanding utility liabilities in the amount of ap-

proximately $18,000. A copy of said order is attached hereto as Exhibit 1 and made a part hereof.

IX.

Under the Hawaii law, the sale of substantially all of the property of a corporation requires the affirmative vote of three-fourths of all stock issued and outstanding and having voting power (§170-30, RLH 1955). At a meeting held October 31, 1950, the stockholders of Hilo Gas, by the necessary vote, authorized the sale of the utility assets of the company to Honolulu Gas and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas executed a bill of sale transferring to Refiners for $18,500 the merchandise, bottled gas and gas appliances and the notes and accounts receivable relating to the appliance sales business and the liquefied petroleum gas business. On October 31, 1950, Hilo Gas and Honolulu Gas executed an instrument whereby Hilo Gas conveyed to Honolulu Gas for $46,000 its utility manufacturing plant and equipment, its distribution system and other utility assets, and Honolulu Gas assumed the liabilities of Hilo Gas. Possession of these assets was not taken by the purchasers until after October 31, 1950.

X.

On October 31, 1950, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and Refiners for a total consideration of $88,-

754.32. Said consideration consisted of cash in the amount of $46,000 paid by Honolulu Gas, cash in the amount of $18,500 paid by Refiners and assumption of liabilities in the amount of $25,254.32 by Honolulu Gas. Honolulu Gas acquired cash, land, buildings and improvements, manufacturing plant, distribution system, machinery and equipment and a portion of the accounts receivable, inventories and supplies. Refiners acquired merchandise, supplies, notes and accounts receivable and inventories relating to the gas appliance sales business and the liquefied petroleum gas business. The land, cash, accounts receivable, merchandise, inventories and supplies were sold at their net book value, so no gain or loss was realized on such sale. The buildings and improvements, the manufacturing plant and equipment, the distribution system and the related facilities (all utility assets) were sold to Honolulu Gas at $122,930.58 less than their net book value. Said utility assets sold to Honolulu Gas consisted of "property used in the trade or business" as defined in Section 111(j)(l), Internal Revenue Code of 1939.

XI.

After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas to Honolulu Gas, the necessary facilities for converting the Hilo system to butane air were ordered. The conversion of the system was completed in March of 1951, and on April 1, 1951, butane air gas was first supplied to the City of Hilo. Until April 1, 1951, all

of the gas furnished to the City of Hilo was manufactured in the old plant of Hilo Gas. The old plant was retained as a stand-by facility for a month or so after April 1, 1951, until it could be ascertained that the butane air system was operating properly. Thereafter, such of the manufacturing facilities of the old plant as were not used in the butane air system were abandoned, scrapped or transferred to the Honolulu Division of Honolulu Gas. The gas mains and distribution system of Hilo Gas were continued in use by Honolulu Gas. Hilo Gas had never claimed an obsolescence or abandonment loss for tax purposes on any of the utility assets sold by it to Honolulu Gas on October 31, 1950. The utility assets sold to Honolulu Gas on October 31, 1950, and abandoned, scrapped or transferred to the Honolulu Division by Honolulu Gas after April 1, 1951, were as follows:

Class of Assets	Net Book Value at October 31, 1950
Boiler Plant Equipment	$ 10,684.48
Equipment and Generators	22,688.88
Purification Equipment	9,976.69
Other Production Equipment	5,485.52
Pumping Equipment	2,568.15
Service Equipment	1,435.93
Total	$ 52,839.65

Utility assets (other than cash, receivables, inventories and supplies) sold to Honolulu Gas on October 31, 1950, which were continued in use in the Hilo operations of Honolulu Gas after April 1, 1951, were as follows:

Class of Assets	Net Book Value at October 31, 1950
Structures and Improvements	$ 11,608.95
Production Equipment	4,588.30
Storage Plant	6,309.92
Gas Mains	42,180.91
Pumping Equipment	2,281.00
Service Equipment	13,793.03
Meters	18,671.57
Office Equipment	4,199.60
Shop Equipment	39.62
Warehouse	2,396.43
Leasehold Improvements	472.77
Tools and Equipment	1,271.60
Transportation Equipment	5,821.45
Total	$113,635.15

XII.

As a result of the sale of said utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss of $117,792.57 for 1950.

XIII.

The taxable year of both Refiners and Hilo Gas was the calendar year. Refiners and Hilo Gas filed consolidated federal income tax returns for the years 1950, 1951, 1952 and 1953. Refiners and Hilo Gas filed separate returns for the years 1954 and 1955. Both companies filed separate Territorial income tax returns for the years 1950-1955, inclusive.

XIV.

In the year 1950, Refiners suffered a loss of $93,-092. In 1951, it had a net income of $17,445 and in 1952, $39,147. It did not have to pay any federal or

Territorial income taxes in those years. In 1953, it had a net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954, it had a net income before income taxes of $215,735.66 and after income taxes (as reported) of $104,977. All of the foregoing figures are on an unconsolidated basis.

XV.

Hilo Gas filed annual Corporation Exhibits required by Territorial law for the the years 1950-1955. In 1951, it reported on this exhibit total income of $19,294.16, total expenses of $18,324.96 and a net income (before taxes) of $969.20. In 1952, it reported a total income of $10,732.76, total expenses of $10,273.26 and a net income (before taxes) of $459.50. In 1953, it reported a total income of $8,600.00, total expenses of $5,830.71 and a net income (before taxes) of $2,769.29. In 1954, it reported total income of $8,600.00, total expenses of $6,009.25 and net income (before taxes) of $2,590.75. In 1955, it reported total income of $8,700.00, total expenses of $6,063.04 and net income (before taxes) of $2,636.96. Hilo Gas was dissolved effective September 18, 1956.

XVI.

At the time of the acquisition of the stock of Messrs. Lyman and Hutchinson on October 6, 1950, no consideration was given by Refiners to the tax aspects of the transaction. The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had

been made to purchase the Lyman and Hutchinson stock. Mr. Lyman has stated that the principal purpose on taking over Hilo Gas was to sell butane not then used by Hilo Gas.

"As far as I know, no investigation was made into the accumulated losses of Hilo Gas or was the matter discussed at any time between Mr. Englebright and myself during the negotiations. The purpose of the purchase of Hilo Gas Co. was to do away with the old manufactured gas plant and replace it with butane shipped in from Pacific Refiners." (Letter of August 27, 1956.)

"Mr. Englebright and I at no time discussed the book value of the assets of Hilo Gas Company.

"It is also my recollection that your accounting staff did not arrive in Hilo until the day I left the company after the sale. This timing I recollect, as pay for my vacation time was left up to your staff. They refused payment. This incident, I believe, helps to place the correct timing of your accountant's access to the books. Mr. Englebright did not look over the books at any time before the purchase." (Letter of September 17, 1956.)

XVII.

It was not until November, 1950, that Refiners obtained advice on the tax aspects of the transaction. Mr. J. C. Rosebrook, the Treasurer of Refiners, consulted with Mr. H. C. Dunn, of Cameron, Tennet and Greaney, who wrote an opinion dated November 15, 1950, pointing out that the loss on the

sale to Honolulu Gas would be an allowable deduction in a consolidated return filed by Refiners and Hilo Gas, but that this would not be an immediate benefit because Refiners did not have any net income. Mr. K. A. Conningham, treasurer of Honolulu Gas, consulted with Mr. A. L. Castle, of Messrs. Robertson, Castle & Anthony, concerning the tax aspects of the Hilo Gas transaction. Mr. Castle advised (opinion dated November 13, 1950, and memorandum dated November 11, 1950) that Honolulu Gas could not acquire the Hilo Gas assets at their book value under Sections 112(b)(6) and 113(a)(5) in order to take advantage of the loss sustained on the abandonment of the manufacturing plant. "If in advance the two sections of the Code had been considered whether we would have any ground to stand on is difficult to say * * *."

XVIII.

The original plan of the new controlling stockholder (Refiners) of Hilo Gas had been to sell the utility assets to Honolulu Gas, to sell the remaining assets to Refiners and to dissolve the corporation at such time as the directors of that company determined in their discretion to be convenient. Actually, Hilo Gas did not sell or distribute all its assets in 1950, and, in fact, it continued its corporate existence and activities until September 18, 1956, when it was dissolved by order of the Treasurer of the Territory of Hawaii. It continued to file the Annual Corporate Exhibit required by the Territorial Corporation Laws, to hold annual meetings of stock-

holders, to hold periodic meetings of directors, to have an independent auditor, to file federal and territorial income tax returns, to pay income taxes, to own property, to receive income and to pay expenses.

XIX.

On October 31, 1950, Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities. On the same date it transferred its merchandise and liquefied petroleum gas business to Refiners for $18,500. Hilo Gas retained certain assets in addition to the $64,500 cash received from the sale of its properties. These assets included merchandise parts inventory (for older types of appliances) amounting to $1,010.64, certain accounts receivable, and a lease of an office building in Hilo. The Hilo Gas balance sheet as of December 31, 1950, shows assets as follows: cash in bank—$14,498.76; notes receivable (Refiners—1% interest) $50,000; accounts receivable (other) $531.30; inventory $904.60; total $65,934.65. On the same date the balance sheet shows accounts payable of $647.97 and other current and accrued liabilities of $106.80, or total current liabilities of $754.77.

XX.

Until September, 1951, Hilo Gas maintained the payrolls, paid the office rent, and provided various other services for Refiners and Honolulu Gas on a cost-plus basis, the cost representing only enough to operate and not including the overhead. In Septem-

ber, 1951, the payroll was transferred to the main office of Honolulu Gas in Honolulu. Hilo Gas maintained a bank account with the Hilo branch of Bishop National Bank until its dissolution in 1956. On April 15, 1955, it entered into a ten-year lease of a butane distribution site with Hilo Sugar Plantation Company. On January 4, 1951, it entered into a lease of an office building at 202-206 Kamehameha Avenue, Hilo, with Adele F. Amiel for a period of two years with an option to renew for five years at a rental of $500 per month. This lease was surrendered in November of 1952. On October 15, 1952, Hilo Gas entered into a lease of an office building at 510 Kamehameha Avenue, Hilo, with C. L. Chow, et al., for a period of five years at a rental of $275 per month. This lease was assigned to Honolulu Gas in 1956 prior to dissolution, with the consent of the lessors. During the period it held these office building leases, Hilo Gas subleased space to Honolulu Gas and Refiners for their Hilo offices. During the period from October 31, 1950, to 1956, Hilo Gas received rental, interest and merchandising income and paid expenses, including a secretary's salary, lease expenses, office supplies, janitor service, directors' fees, pensions to retired employees and federal and territorial taxes. Its income and expenses for the years 1951-1955 are given in Paragraph XV above. Copies of the Annual Corporation Exhibits of Hilo Gas for the years ended December 31, 1951, December 31, 1952 and December 31, 1953, are attached hereto as Exhibit 2 and made a part hereof.

XXI.

On several occasions after 1951, the question of liquidating Hilo Gas was raised by various of the directors, but it was decided to maintain its corporate existence in view of the possible uses that might be made of the corporation. At one time discussions were held with the Bishop National Bank relative to the possibility of financing liquefied petroleum gas tank purchases through Hilo Gas. Discussions were also held with J. Barth & Co. in San Francisco and the Secretary of the Territorial Retirement System with respect to financing through Hilo Gas. The reason that Hilo Gas entered this picture was the fact that lending institutions were generally prohibited from investing in corporations of a relatively few years' existence, and as Refiners had experienced difficulty in financing for this reason, it was thought that Hilo Gas, with its longer record of corporate existence, might be useful. In addition, the possibility of giving Hilo Gas a franchise for the distribution of Isle-Gas on the Island of Hawaii was considered.

XXII.

Refiners included the net loss from the sale in October, 1950, of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas. The Commissioner of Internal Revenue has disallowed this item. The explanation given in the statement attached to the 150-day letter of the

Appellate Division dated May 15, 1957, is as follows:

"On your return for the calendar year 1953, you claimed a net operating loss deduction of $145,325.46. Included in this figure is an amount of $116,405.64 allegedly representing a net loss carry-over of Hilo Gas Company, Ltd., originating in the year 1950, computed as follows:

Purported loss from sale of utility assets to Honolulu Gas Company, Ltd., on October 31, 1950..		$122,930.58
Less:		
Net operating profit—Hilo Gas Company, Ltd.—1950.....	$5,138.01	
Net operating profit—Hilo Gas Company, Ltd.—1951.....	969.20	
Net operating profit—Hilo Gas Company, Ltd.—1952.....	417.73	6,524.94
Net operating loss carry-over claimed as deduction in 1953.....		$116,405.64

Affiliation with Hilo Gas Company, Ltd., occurred some time in October, 1950.

"It is held that, in substance, no deductible loss was sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in 1950. In the event that a loss was sustained as a result of this transaction, it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effec-

tive. Accordingly, the net loss, if any, sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is, therefore, disallowed."

XXIII.

On June 4, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, paid a deficiency of $58,472.39, together with interest of $11,-301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas in 1950 upon the sale of the utility assets to Honolulu Gas. Said payment was made to the District Director of Internal Revenue in Honolulu.

XXIV.

On August 28, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1953 covering said principal amount of $58,472.39 and said payment of interest of $11,-301.99. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954 and its predecessor sections of the Internal Revenue Code of 1939. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

XXV.

On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $69,774.38 for the year 1953 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 3772(a), Internal Revenue Code of 1939.

XXVI.

No amount has been paid or refunded to plaintiff on account of said sums of $58,472.39 (principal) and $11,301.99 (interest) claimed as income tax and interest by defendant for the taxable year 1953 and assessed and collected by defendant from plaintiff.

XXVII.

The stockholders of Refiners on November 25, 1955, adopted a plan of complete liquidation which provided for the sale of the refinery facilities to Standard, the sale of the Isle-Gas business and related assets to Honolulu Gas and the liquidation and dissolution of the corporation. Pursuant to this plan, the refinery facilities were sold to Standard on December 6, 1955, and the Isle-Gas business and assets were sold to Honolulu Gas on December 31, 1955. Thereafter, and within a period of twelve months from the date of adoption of the plan of liquidation, the affairs of the corporation were wound up, all of the assets of the corporation were distributed in complete liquidation, less assets retained to meet claims, and the corporation was dissolved by order of the Treasurer of the Territory of Hawaii on

November 19, 1956. No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas as aforesaid, pursuant to the provisions of Section 337, Internal Revenue Code of 1954.

XXVIII.

In its tax return for the year 1955, Refiners claimed a deduction for organization expenses of $43,163.48. Included therein was the amount of $30,678.62 relating to expenses in connection with the issue of capital stock, $9,259.74 in 1950 and $21,418.88 in 1951. With respect to this item, the statement attached to the Appellate Division 150-day letter dated May 15, 1957, states:

"It is held that these expenses incurred in marketing your capital stock do not constitute organization expenses but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital. The deduction of $30,678.62 claimed is, therefore, disallowed."

XXIX.

Refiners in its 1955 income tax return claimed a deduction for accrued territorial net income taxes of $67,648.77, based on the net income reportable for territorial net income tax purposes, which income included (1) the gain from the sale of refinery facilities and related assets to Standard and (2) the gain from the sale of the Isle-Gas business and related assets to Honolulu Gas in December, 1955. The total territorial income tax paid by Refiners for the calendar year 1955 was $74,408.15, of which

$59,089.97 was paid at the time of filing its return and $15,318.18 was paid in 1956 as the result of a deficiency assessed by the Territorial Tax Collector in that year. The Commissioner has disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets under the provisions of Section 265 of the Internal Revenue Code of 1954, stating in his 150-day letter that said section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for federal income tax purposes, was $61,061.59.

XXX.

The Commissioner assessed a deficiency of $51,468.20, together with interest of $3,850.97, against Refiners for 1955, principally because of his disallowance of the capital stock expense ($30,678.62) and his disallowance of 1955 Territorial income taxes ($61,061.59) as set forth above. Plaintiff, as Trustee in dissolution of Refiners, paid said deficiency and interest to the District Director of Internal Revenue in Honolulu as follows: $35,670.31 on June 4, 1957; $1,560.73 on July 26, 1957; and the balance of $18,088.13 by credit on July 23, 1957.

XXXI.

On August 28, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the

District Director of Internal Revenue in Honolulu for the year 1955 in the amount of $51,219.79 plus interest of $3,753.77, or a total of $54,973.56. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

XXXII.

On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $54,973.56 for the year 1955 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 6532 (a)(1), Internal Revenue Code of 1954.

XXXIII.

No amount has been paid or refunded to plaintiff of said sums of $51,219.79 (principal) and $3,753.77 (interest) claimed as income tax and interest by defendant for the taxable year 1955 and assessed and collected by defendant from plaintiff.

Dated: Honolulu, T. H., this 28th day of November, 1958.

HAWAIIAN TRUST
COMPANY, LIMITED,
A Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation;

By /s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

UNITED STATES OF AMERICA,

By /s/ LOUIS B. BLISSARD,
United States Attorney, District of Hawaii; Attorney for Defendant.

EXHIBIT No. 1

Before the Public Utilities Commission
of the Territory of Hawaii

Docket No. 1108

In the Matter of the Application of

HILO GAS COMPANY, LIMITED, for Authority to Sell Its Utility Assets.

Order No. 708

This matter came before the Commission upon application of Hilo Gas Company, Limited, hereinafter referred to as the "Company" or "Applicant," filed October 20, 1950, wherein Applicant requests authority to sell its utility assets, including its franchise, to Honolulu Gas Company, Limited.

The application was before the Commission at a hearing held on October 26, 1950. J. Garner Anthony, Esq., of the firm of Robertson, Castle and Anthony, appeared for the Applicant; Michiro Watanabe, Esq., Assistant Attorney General, appeared for the Commission.

The Company presented its case consisting of its application and the testimony of three witnesses[1]. The Commission's staff did not submit a report in the matter as it had received the application only six days prior to the hearing; however, the staff advised the Commission of its full knowledge of all matters related to the application and recommended approval thereof.

Applicant proposes to sell, assign, transfer and convey to Honolulu Gas Company, Limited, for a total consideration of approximately $64,000, all of its utility assets, including its franchise, but excluding its non-utility assets, which consist of merchandise, goods, notes and accounts receivable related to its appliance sales business and liquefied petroleum gas business.

The record shows that the Honolulu Gas Company, Limited, has agreed to purchase the utility assets of Applicant on the terms set forth hereinabove, upon approval of the Company's application by this Commission. The record further shows that the present gas manufacturing plant of Applicant is obsolete, that its production costs are high, that the cost of a new manufacturing gas plant is prohibitive, and that the Honolulu Gas Company, Limited, upon approval of the proposed sale and acquisition, plans to abandon Applicant's present gas manufacturing plant and to employ its distribution system in distributing a butane-air gas, as soon as

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[1]A. E. Englebright, K. A. Conningham, L. L. Gowans.

the necessary work of conversion can be accomplished.

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that the proposed sale of Applicant's utility assets to the Honolulu Gas Company, Limited, is in the public interest. It also appears in the public interest that the proposed sale be consummated at the earliest possible date. The Commission will, therefore, authorize Applicant to sell its utility assets to the Honolulu Gas Company, Limited, immediately.

Now, therefore, it is hereby

Ordered: That Applicant be and it is hereby authorized to sell, assign, transfer and convey all of its utility assets, including its franchise, to the Honolulu Gas Company, Limited, for a total consideration of approximately $64,000, consisting of a cash payment of approximately $46,000 for its utility assets and the assumption by the purchaser of outstanding utility liabilities in the amount of approximately $18,000.

Done at Honolulu, City and County of Honolulu, Territory of Hawaii, this 26th day of October, 1950.

PUBLIC UTILITIES COMMISSION OF THE TERRITORY OF HAWAII,

By /s/ J. H. HUGHES,
Acting Chairman;

By /s/ LEO G. LYCURGUS,
Commissioner;

By /s/ J. M. O'DOWDA,
Commissioner;

By /s/ F. G. MANARY,
Commissioner;

By /s/ A. C. BAPTISTE, JR.,
Commissioner.

Attest:

I, Jean Kenny Bradford, Executive Secretary of the Public Utilities Commission of the Territory of Hawaii, do hereby certify that the foregoing Order No. 708 is a full, true and complete copy of original on file in the office of the Commission.

/s/ JEAN KENNY BRADFORD,
Secretary.

[Endorsed]: Filed November 15, 1950, Public Utilities Commission, T. H.

File Number

ANNUAL CORPORATION EXHIBIT

OF

HILO GAS COMPANY, LIMITED

P. O. Box 3965, Honolulu, Hawaii
(Principal Office)

For the Fiscal Period Ended December 31, 1951

Date of Incorporation July 24, 1916

Authorized Capital: Class	Shares	Par Share	Par Total
Pfds. 6% Cum.	30,000	$ 20.00	$ 600,000.00
Pfds. 7%	2,000	$ 20.00	$ 40,000.00
Common	5,000	$ 20.00	$ 110,000.00
		$	$

Paid-In Capital: Class	Shares	Amount
Pfds. 6% Cum.	2,283	$ 45,660.00
Pfds. 7%	1,515	$ 30,300.00
		$

FILING FEE OF $10.00
Paid on:

Form prescribed
WILLIAM R. BREAKS
Treasurer of the Territory of Hawaii

Form approved January 29, 1945
BUREAU OF THE BUDGET

Nature of corporate business: Manufacturing & distribution of gas

Officers and directors as of December 31, 1951

Office Held	Name in Full	Residence Address
President	Everett E. Black	2020 Matt-Smith Dr., Honolulu
Vice-president	A. Eugene Englebright	3039 Gail, Honolulu
Secretary-treasurer	John C. Rosebrook	3111 Diamond Head Rd., Honolulu

*Directors:		
	Everett E. Black	2020 Matt-Smith Dr., Honolulu
	A. Eugene Englebright	3039 Gail, Honolulu
	Chauncey B. Hopkins	3137 Cabs Ave., Honolulu
	Cyril F. Damon	2920 Manoa Ave., Honolulu
	J. Howard Worrall	65 Dowsett Ave., Honolulu

*Majority of whom must be residents of the Territory of Hawaii

DECLARATION

I declare under the penalties set forth in Section 8348, Revised Laws of Hawaii 1945, as amended, that this exhibit including any accompanying schedules or statements, has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete exhibit, made in good faith, for the fiscal period stated. This exhibit must be filed and the filing fee of $10.00 paid to the Treasurer within ninety days immediately following the close of the calendar year or fiscal year, depending upon the year basis adopted.

(Signature of person or firm preparing this exhibit) (Signature of authorized corporate officer)

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will make this exhibit not acceptable. To file this exhibit on other than a calendar year basis, permission must first be obtained from the Treasurer of the Territory of Hawaii.

EXHIBIT 2

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ANNUAL CORPORATIC XHIBIT OF [redacted] DITED

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period T
ASSETS				
Current				
Cash on hand and in bank		14,499.75		7,549.63
Accounts receivable	533.30		2,498.07	
Less reserve for bad debts		533.30		2,498.
Notes receivable		50,000.00		50,000.
Inventories				
Finished goods				
Raw materials and supplies		904.60		631.26
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U.S. government				
State, municipal				
All other				
Fixed				
Land				
Leasehold				
Buildings				
Machinery and equipment				
Furniture and fixtures				
Delivery equipment				
Total			3,843.85	
Less reserve for depreciation			689.60	3,154.25
Prepaid expenses				565.88
Unexpired insurance				
Interest				
Other assets				
Total assets		65,934.65		64,499.09
LIABILITIES AND CAPITAL				
Current				
Accounts payable		4,498.50		1,933.75
Notes payable				
Accrued expenses				
Payroll				
Interest				
Income tax				
Other taxes				
Fixed				
Mortgage payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued	84,240.00		84,240.00	
Common stock issued				
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(22,803.85)		(21,834.65)	
Total		61,436.15		62,405.25
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		65,934.65		64,339.00

EXHIBIT 2

FOR THE FISC .4 OD ENDED December 31, [illegible]

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period Detail	Last Preceding Period Total	Current Period Detail	Current Period Total
Net sales (where inventories are used)		28,171.17		1,21[illegible]
Inventory at beginning of period	5,661.95		904.60	
Merchandise purchased or manufactured	25,900.09		616.61	
Total	31,562.04		1,521.21	
Less inventory at end of period	904.60		631.26	
Cost of goods sold		30,257.42		889.9[illegible]
Gross profit on sales (Loss)		(2,086.25)		528.[illegible]
Gross revenues (where inventories are not used)	158,[illegible].37		63,566.05	
Less cost of operation	122,759.96	35,276.31	55,200.44	8,365.[illegible]
Gross profit		33,190.06		8,892.[illegible]
Add other income				
Interest	392.43		500.00	
Dividends				
Rents			9,900.00	
Sundry	5.00			
		397.43		10,400.[illegible]
Total income		33,587.49		19,29[illegible]
Less expenses				
Officers' salaries			100.00	
Other salaries and wages			5,127.31	
Depreciation	10,600.22		689.65	
Bad debts	1,800.00			
Interest	714.38			
Taxes other than income	12,861.88		3,463.[illegible]	
Rent	2,500.00		6,[illegible]	
Other	75.00		2,596.17	
Loss on sale of property	122,890.58			
		151,382.06		18,124.[illegible]
Net income (or loss) before income taxes		(117,794.57)		969.[illegible]
Income taxes				
Net income (or loss) transferred to surplus		(117,794.57)		969.[illegible]
Surplus at beginning of period		94,984.72		
Add credits to surplus (detail)				
Total		(22,809.85)		[illegible]
Add at beginning of period				[illegible]
Add (surplus detail)				
Net (or deficit) at end of period		(22,809.85)		[illegible]

CAPITAL STOCK

Issued during the fiscal period ( ) shares preferred stock at $ per share
( ) shares common stock at $ "

Consideration received for stock
Issued during the fiscal period ($ cash
($ value of property
($ value of services

Retired during the fiscal period (shares preferred stock
(shares common stock

Reacquired during period ($ cash
(Other manner

Reissued during
the period (shares preferred stock
(shares common stock

Consideration received for stock
issued during the fiscal period ($ cash
($ value of property
($ value of services

FUNDED DEBT
Issued during the fiscal period ($ par value

Consideration received for bonds
issued during the fiscal period ($ cash
($ value of property
($ value of services

EXHIBIT 2

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Name In Full	Mailing Address	Shares	Par Value
	8% Preferred - Cum.		
[illegible]	614 Kilauea Ave., Hilo, Hawaii	1	
[illegible] Chong	Inter-Island Drug Co., Lahaina	1	
Pacific Refiners, Ltd.	75 S. King St., Honolulu	2,281	
	Total 8% Preferred		
	7% Preferred		
[illegible] San Ching	c/o George Tung, 76 Derby, Hilo	5	
[illegible] Kong Yee	1973 Panaa St., Hilo	2	
[illegible] Silva	c/o Mrs. Caroline Silva, Huntington Park, Calif.	5	
[illegible] Kitagawa	I. Kitagawa & Co., Hilo	5	
[illegible] ah Mai	151 Panaewa St., Hilo	2	
[illegible] Willeong	Hilo, Hawaii	5	
[illegible] Chew	614 Kilauea Ave., Hilo	10	
[illegible] Lopes deSilva	Lampake-shoe, Hawaii	3	
[illegible] L. Camarin	Makalea, Hawaii	2	
[illegible] Chong	Inter-Island Drug Co., Lahaina	6	
[illegible] West, Wom. of Marie West	1046 Koko Head Ave., Honolulu	2	
[illegible] Young	98 Prospect St., Honolulu	5	
[illegible] Carvalho	394 Haili St., Hilo	5	
[illegible] Carvalho	394 Haili St., Hilo	5	
Pacific Refiners, Ltd.	75 S. King St., Honolulu	1,857	
[illegible] Chock	2020 Metcalf St., Honolulu	1	
[illegible] Applebright	3039 Cail, Honolulu	1	
[illegible] Carroll	2920 Nuuanu Ave., Honolulu	1	
[illegible] Brightman	3137 Kalia Ave., Honolulu	1	
[illegible], Trustee for [illegible] & Alice Fukushima	McCandless Bldg., Honolulu	5	
[illegible] Howard Portell	65 Dowsett Ave., Honolulu	1	

EXHIBIT 2

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ANNUAL CORPORATION EXHIBIT

OF

HILO GAS COMPANY, LIMITED

P. O. Box 1900, Honolulu, Hawaii
(Mailing Address)

For the Year Ended December 31, 1942

Date of Incorporation July 21, 1916

Authorized Capital:

Class	Shares	Par Share	Par Value
Pfd. 6% Cum.	3,000	$ 20.00	$ 60,000.00
Pfd. 7%	2,000	$ 20.00	$ 40,000.00
Common	5,500	$ 20.00	$ 110,000.00

Paid in Capital:

Class	Shares	Amount
Pfd. 6% Cum.	2,263	$ 45,260.00
Pfd. 7%	1,929	$ 38,580.00

Filing fee of $10.00 paid on:

Nature of corporate business Manufacturing and Distributing of Gas

Officers and directors as of December 31, 1942

HILO GAS COMPANY

DIRECTORS

E. E. Black
President, E. E. Black, Ltd.
1067 Kawaiahao

A. E. Englebright
Vice President and General Manager
Honolulu Gas Company, Ltd.
75 S. King Street

C. F. Damon
President, Bishop Trust Company, Ltd.
141 S. King Street

C. B. Wightman
Vice President, Alexander & Baldwin, Ltd.
822 Bishop Street

J. Howard Worrall
President, K. O. M. B.
1534 Kapiolani Blvd.

OFFICERS

E. E. Black, President

A. E. Englebright, Vice President

J. C. Rosebrook, Secretary-Treasurer
Honolulu Gas Company, Ltd.
75 S. King Street

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will make this exhibit not acceptable. To file this exhibit on other than a calendar year basis, permission must first be obtained from the Treasurer of the Territory of Hawaii. This exhibit must be filed, and the filing fee of $10.00 paid to the Treasurer within NINETY DAYS immediately following the close of the year basis adopted. Failure to file will subject the corporation to a maximum penalty of $100.00 for every thirty days continuance, and if continued for a period of two years will further subject the corporation to dissolution by the Treasurer.

EXHIBIT 2

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ANNUAL CORPORATIC XHIBIT OF

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period Total
ASSETS				
Current				
Cash on hand and in bank				
Accounts receivable	3,498.07			
Less reserve for bad debts				
Notes receivable		50,000.00		
Inventories				
Finished goods				
Raw materials and supplies		631.00		
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U. S. government				
—State, municipal				
—All other				
Fixed				
Land				
Leasehold				
Buildings	1,708.89			
Machinery and equipment				
Furniture and fixtures	235.00			
Delivery equipment				
Total	3,843.85			
Less reserve for depreciation	689.60	3,154.25		
Prepaid expenses		505.89		
Unexpired insurance				
Interest				
Other assets				
Capital stock subscription				
Total assets		84,339.09		
LIABILITIES AND CAPITAL				
Current				
Accounts payable		1,933.74		
Notes payable				
Accrued expenses				
Payroll				
Interest				
Income taxes				
Other taxes				
Fixed				
Mortgages payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued	84,260.00		84,260.00	
Common stock issued				
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(21,854.65)	62,405.35		
Total				
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		84,339.09		

EXHIBIT 2

FOR THE ... December 31, 19...

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period		Current Period	
	Detail	Total	Detail	Total
Net sales (where inventories are used)		[illegible]		[illegible]
Inventory at beginning of period	[illegible]			
Merchandise purchased or manufactured				
Total				
Less inventory at end of period				
Cost of goods sold				
Gross profit on sales				16,23
				(4,76)
Gross revenues (where inventories are not used)				
Less cost of operation				
Gross profit				
Add other income				
Interest				
Dividends		300.00		300,00
Rents		9,900.00		10,237,50
Total income		10,200.00		10,537,50
Less expenses				
Officers' salaries	300.00		300,00	
Other salaries and wages	5,100.00			
Depreciation	600.00		575.00	
Bad debts				
Interest				
Taxes other than income				
Rent	1,500.00		685.85	
Other	6,300.00		5,461.66	
	2,500.00		3,250.14	
Net income (or loss) before income taxes		10,300.00		10,272.65
Income taxes		900.00		459.50
Net income (or loss) transferred to surplus		900.00		459.50
Surplus at beginning of period				
Add credits to surplus (detail)				
Total		900.00		459.
Deficit at beginning of period		(20,803.85)		(21,834.00)
Less debits to surplus (detail)				
Surplus (or deficit) at end of period		(20,834.85)		(21,375.50)

CAPITAL STOCK:

Issued during the period
(____ shares preferred stock at $____ per value)
(____ shares common stock at $____ per value)

Consideration received for stock issued during the period
($____ cash)
($____ value of property)
($____ value of services)

Acquired during the period
(____ shares preferred stock)
(____ shares common stock)

How acquired
($____ cash)
(Other manner: ____)

Acquired stock released during the period
(____ shares preferred stock)
(____ shares common stock)

Consideration received for stock released during the period
($____ cash)
($____ value of property)
($____ value of services)

BONDED DEBT:

Issued during the period
($____ par value)

Consideration received for bonds issued during the period
($____ cash)
($____ value of property)
($____ value of services)

EXHIBIT 2

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VOTING POWERS AND STOCKHOLDERS

(a) Does each share of stock have the right to vote? Yes If not, explain voting rights:

(b) Has any class of stock or exception any special privileges in the election of directors, trustees, or other management personnel, or in the determination of any corporate action? No If so, give details:

(c) State the total voting power of all stockholders as of the date of this report 4,812

(d) State the total number of stockholders as of the date of this report 21

(e) In the space below, set forth the names of the registered owners and in accordance with the columns headings indicated, the stockholdings by each class of stock. If the stock is held by a Trustee, make a full disclosure of the names, addresses and shares of the equitable owners. If the stock is without par value, then under the subscription price, the total amount of the subscription, and [illegible] showing the total consideration received from the sale thereof as to each stockholder.

Name in Full	Mailing Address	Total Subscription	
		Shares	Par Value

HILO GAS COMPANY

LIST OF STOCKHOLDERS

As of December 31, 1938

FIRST PREFERRED - 8%

Cert. No.	Name of Stockholder	Address	No. Shares	
68	Chuck Chong	Inter-Island Drug Co., Lahaina	1	$ 20.00
77	Pacific Refinery, Ltd.	75 S. King St., Honolulu	(1,750	
78	" " "	" " "	2,282 (323	45,640.00
79	" " "	" " "	(9	
		Total	2,282	45,660.00

SECOND PREFERRED - 7%

20	T. Sam Ching (deceased)	c/o Geo. Tung, 76 Derby, Hilo	5	100.00
21	Young Kong Yee	c/o Hawaii Egg Needle Mfg.Co., Hilo	2	40.00
30	I. Kitagawa	I. Kitagawa & Co., Hilo	5	100.00
31	Charles Ah Hai	151 Punaroa St., Hilo	2	40.00
33	E. C. Willfong(dec'd)	Hilo, Hawaii	5	100.00
66	Frank Lopez De Silva	Laupahoehoe, Hawaii	2	40.00
68	Cecelia E. Cevario	Kohalau, Hawaii	2	40.00
69	Chuck Chong	Inter-Island Drug Co., Lahaina	6	120.00
82	Frank Lopez Silva	Laupahoehoe, Hawaii	1	20.00
83	Henry Vest, Guardian	1088 Kuhio Road Ave., Honolulu	2	40.00
96	K. Y. Young Hu	983 Prospect St., Honolulu	5	100.00
214	Ortan C. Carvalho	358 Kalii St., Hilo	5	100.00
215	Carlos C. Carvalho	358 Kalii St., Hilo	5	100.00
235	Pacific Refinery, Ltd.	75 S. King St., Honolulu	1,867	37,340.00
236	E. E. Black	1087 Kawaiahao, Honolulu	1	20.00
237	A. E. Eggleright	75 S. King St., Honolulu	1	20.00
239	Cyril Damon	Bishop Trust Co., 141 S. King St., Honolulu	1	20.00
240	Chauncey B. Wightman	Alexander & Baldwin, 822 Bishop St., Honolulu	1	20.00
241	Peter Lee, Trustee	(Unknown)	5	100.00
242	M. A. Silva (Dec'd)	c/o Carolina Silva, Huntington Park, Calif.	5	100.00
243	J. Howard Worral	K.C.M.B., 1534 Kapiolani Blvd., Honolulu	1	20.00
		Total	1,929	$38,580.00

EXHIBIT 2

ANNUAL CORPORATION EXHIBIT

OF

HILO GAS COMPANY, LIMITED

P. O. Box 1940, Honolulu, Hawaii
(Mailing Address)

For the Year Ended December 31, 1953

Date of Incorporation August 21, 1936

Authorized Capital:	Shares	Par Value Per Share	Par Value Total
Class			
Pfd. 6% Cum.	3,000	$ 20.00	$ 60,000.00
Pfd. 7%	2,500	$ 20.00	$ 50,000.00
Common	7,500	$ 20.00	$ 150,000.00

Paid In Capital:	Shares	Amount
Class		
Pfd. 6% Cum.	2,283	$ 45,660.00
Pfd. 7%	1,969	$ 39,380.00

Filing fee of $10.00 paid on:

Nature of corporate business: Rental and sundry services

Officers and directors as of December 31, 1953:

Office Held	Name in Full	Residence Address
	HILO GAS COMPANY, LIMITED	
Directors		
	A. S. Englebright	2020 Oahu
	C. F. Dason	2020 Nuuanu Ave.
	[illegible] H. Wightman	3147 Oahu Ave.
	J. Howard Worrall	2130 Pauahi Place
Officers		
	[illegible] E. Black, President	2020 Kapiolani Drive Honolulu
	A. S. Englebright, Vice President	[illegible]
	[illegible] Rosebrook, Secretary-Treasurer	[illegible] Drive

(Signature of person or firm preparing this exhibit) (Signature of authorized officer)

Date Office Held

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will result in [illegible]

To file this exhibit on other than a calendar year basis permission must first be obtained from the Treasurer of Hawaii. This exhibit must be filed and the filing fee of $10.00 paid to the Treasurer within [illegible] days following the close of the year herein adopted. Failure to file will subject the corporation to a penalty of $5.00 for every thirty days continuance, and if continued for a period of two years will be subject to [illegible] by the Treasurer.

EXHIBIT 2

ANNUAL CORPORATION EXHIBIT OF [illegible] GAS COMPANY [illegible]

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period Total
ASSETS				
Current				
Cash on hand and in bank		8,577.26		
Accounts receivable	4,216.59		4,303.-	
Less reserve for bad debts		4,216.59		
Notes receivable		50,000.00		
Inventories				
Finished goods				
Raw materials and supplies				
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U. S. government				
—State, municipal				
—All other				
Fixed				
Land				
Leasehold				
Buildings				
Machinery and equipment	135.00		[illegible]	
Furniture and fixtures				
Delivery equipment				
Total	135.00		[illegible]	
Less reserve for depreciation	[illegible]	106.06	[illegible]	
Prepaid expenses		137.50		
Unexpired insurance				
Interest				
Other assets				
Capital stock subscription				
Total assets		63,037.67		
LIABILITIES AND CAPITAL				
Current				
Accounts payable		138.06		
Notes payable				
Accrued expenses				
Payroll				
Interest				
Income taxes				
Other taxes		34.78		
Fixed				
Mortgage payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued	84,289.00		[illegible]	
Common stock issued				
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(21,375.15)	62,864.83	[illegible]	
Total				
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		63,037.67		

EXHIBIT 2

FOR THE YEAR ENDED December 31, 19[illegible]

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period Detail	Last Preceding Period Total	Current Period Detail	Current Period Total
Sales (where inventories are used)		[illegible]		
Inventory at beginning of period				
Merchandise purchased or manufactured				
Total				
Inventory at end of period				
Cost of goods sold		146.23		
Gross profit on sales		(4.75)		
Gross revenues (where inventories are not used)				
Gross cost of operation				
Gross profit		(4.75)		
Add other income				
Interest		500.00		
Dividends				
Rents		10,237.50		
Total income		10,732.76		
Less expenses				
Officers' salaries	300.00			
Other salaries and wages				
Depreciation	275.59			
Bad debts				
Interest				
Taxes other than income	685.85			
	5,461.68		3,20[illegible]	
	3,250.14		[illegible]	
		10,273.26		
Net income (or loss) before income taxes		459.50		
Income taxes				
Net income (or loss) transferred to surplus		459.50		
Surplus at beginning of period				
Add credits to surplus (detail)				
Total		459.50		
Deficit at beginning of period		(21,834.65)		
Less debits to surplus (detail)				
1962 Territorial income tax				(4[illegible]
Surplus (or deficit) at end of period		(21,375.15)		[illegible]

CAPITAL STOCK

Issued during the period — (____ shares preferred stock at $____ par value
(____ shares common stock at $____ par value

Consideration received for stock issued during the period — ($____ cash
($____ value of property
($____ value of services

Acquired during the period — (____ shares preferred stock
(____ shares common stock

How acquired — ($____ cash
(Other manner: ____

Acquired stock reissued during the period — (____ shares preferred stock
(____ shares common stock

Consideration received for stock reissued during the period — ($____ cash
($____ value of property
($____ value of services

BONDED DEBT:

Issued during the period — ($____ par value

Consideration received for bonds issued during the period — ($____ cash
($____ value of property
($____ value of services

EXHIBIT 2

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TING POWERS AND STOCKH' RS

(a) Does each share of stock have the right to vote? _____ If not, explain voting rights _____

(b) Has any class of stock or securities any special privileges in the election of directors, trustees, or other management personnel, or in the determination of any corporate action? _____ If so, give details _____

(c) State the total voting power of all stockholders as of the date of this report _____

(d) State the total number of stockholders as of the date of this report _____

(e) In the space below, or on sheets attached thereto and in accordance with the column headings indicated, list all stockholders by each class of stock. If the stock is held by a Trustee, make a full disclosure of the names, addresses and shares of the equitable owners. If the stock is without par value, then state the subscription price, the total paid in on account of the subscription, and furnish a statement showing the total consideration received from the sale of stock distributed as to capital and as to paid-in surplus.

HILO GAS COMPANY

LIST OF STOCKHOLDERS

As of December 31, 1951

FIRST PREFERRED - 8%

Cert. No.	Name of Stockholder	Address	No. Shares	
68	Chock Chang	Inter-Island Drug Co., Lahaina	1	$ 20.00
77	Pacific Refiners, Ltd.	75 S. King St., Honolulu	2,282 (1,750	
78	" " "	" " "	523	45,640.00
79	" " "	" " "	(9	
		Total	2,283	45,660.00

SECOND PREFERRED - 7%

20	T. Sam Ching (deceased)	c/o Geo. Tung, 76 Berry, Hilo	5	100.00
21	Young Kang Yoo	c/o Hawaii Egg Noodle Mfg.Co., Hilo	2	40.00
30	I. Kitagawa	I. Kitagawa & Co., Hilo	5	100.00
31	Charles Ah Hai	151 Punawai St., Hilo	2	40.00
33	H. C. Willfung(dec'd)	Hilo, Hawaii	5	100.00
66	Frank Lopes De Silva	Laupahoehoe, Hawaii	2	40.00
68	Cecelia K. Cevarlo	Hakalau, Hawaii	2	40.00
69	Chock Chang	Inter-Island Drug Co., Lahaina	6	120.00
82	Frank Lopes Silva	Laupahoehoe, Hawaii	1	20.00
83	Henry Woot, Guardian	1026 Koko Head Ave., Honolulu	2	40.00
96	H. Y. Young Hn	983 Prospect St., Honolulu	5	100.00
214	Urban C. Carvalho	394 Haili St., Hilo	5	100.00
215	Carlos G. Carvalho	394 Haili St., Hilo	5	100.00
235	Pacific Refiners, Ltd.	75 S. King St., Honolulu	1,867	37,340.00
236	E. E. Black	1067 Kawaihae, Honolulu	1	20.00
237	A. E. Englebright	75 S. King St., Honolulu	1	20.00
239	Cyril Damon	Bishop Trust Co., 141 S. King St., Honolulu	1	20.00
240	Chauncey B. Wightman	Alexander & Baldwin, 822 Bishop St., Honolulu	1	20.00
241	Peter Lee, Trustee	(Unknown)	5	100.00
242	M. A. Silva (Dec'd)	c/o Carolina Silva, Huntington Park, Calif.	5	100.00
243	J. Howard Worral	K.G.M.B., 1534 Kapiolani Blvd., Honolulu	1	20.00
		Total	1,929	$38,580.00

[Endorsed]: Filed December 1, 1954.

EXHIBIT 2

[Title of District Court and Cause.]

STIPULATION WITH RESPECT TO QUESTIONS OF LAW

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that the following are the questions of law raised in this case, upon which the parties are in disagreement, and that these are the only questions of law involved:

First Issue

Can the net operating loss suffered by Hilo Gas Company, Limited, in 1950 be carried forward by its parent, Pacific Refiners, Limited, on a consolidated return basis to the year 1953?

The position of the taxpayer is that, under the plain terms of the statute (Sec. 141, Internal Revenue Code of 1939) and the Consolidated Return Regulations, Pacific Refiners, Limited, is entitled to carry forward the Hilo Gas 1950 loss as a consolidated net operating loss to 1953; that there was a sound business purpose for the acquisition of control of Hilo Gas by Pacific Refiners and that there was no tax evasion or avoidance purpose.

The position of the government is that the carry forward can be denied because the "principal purpose" of the acquisition of control of Hilo Gas was tax evasion or avoidance within the meaning of Section 129 of the Internal Revenue Code of 1939

or because there was no "business purpose" for the acquisition or because there was no "economic loss" to the parent corporation.

Second Issue

Can Pacific Refiners, Limited, deduct in the year of its liquidation expenses of selling its capital stock?

The taxpayer's position is that these expenses are deductible in the year of complete liquidation.

The government's position is that these expenses are not deductible in any year.

Third Issue

Can Pacific Refiners, Limited, deduct in 1955 Territory of Hawaii income taxes allocable to gain from the sale of its properties realized in 1955 but not recognized for federal income tax purposes by reason of Section 337 of the Internal Revenue Code of 1954?

The taxpayer's position is that the Hawaii income taxes are deductible under Section 164(a) of the Internal Revenue Code of 1954 and that Section 265 of the Internal Revenue Code of 1954 is not applicable.

The government's position is that Section 265 is applicable, and that for this reason the deduction for Territorial taxes was correctly disallowed.

Dated: Honolulu, Hawaii, September 2, 1959.

HAWAIIAN TRUST
COMPANY, LIMITED,
A Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation;

By /s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

UNITED STATES OF
AMERICA,

By /s/ LOUIS B. BLISSARD,
United States Attorney, District of Hawaii; Attorney for Defendant.

Filed: September 2, 1959.

[Endorsed]: Filed September 2, 1959.

[Title of District Court and Cause.]

OPINION AND JUDGMENT

While counsel for the plaintiff has shown considerable industry and ingenuity in presenting his arguments, that industry and that ingenuity have not availed to counterbalance the essentially tenuous character of his reasoning.

In contrast, the defendant's position is simple, clear, and based upon elementary logic, as well as

being supported by statute law and the applicable Treasury Regulations.

1. Statement of the Case.

The plaintiff seeks recovery of $109,692.18, representing the principal amount of income taxes alleged to have been illegally and erroneously assessed and collected for 1953 and 1955, plus interest paid thereon, amounting to $15,055.76, or a total of $124,747.94. In addition, the plaintiff claims that it is entitled to interest on the entire amount of principal and interest paid. In other words, there is presented the familiar problem of "interest on interest."

The amounts of the alleged overassessments and overpayments are claimed by the plaintiff to be as follows:

Year	Principal	Interest	Total
1953	$ 58,472.39	$11,309.99	$ 69,774.38
1955	51,219.79	3,753.77	54,973.56
	$109,692.18	$15,055.76	$124,747.94

The parties have stipulated that three issues are presented in this case, as follows:

I.

Can the net operating loss suffered by Hilo Gas Company, Limited, hereinafter Hilo Gas, in 1950 be carried forward by its parent, Pacific Refiners, Limited, hereinafter Refiners, on a consolidated return basis to 1953?

The plaintiff's position is that, under the plain terms of the statute ((Section 141, Internal Revenue Code (hereinafter sometimes the Code) of 1939)) and the Consolidated Return Regulations, Refiners is entitled to carry forward the Hilo Gas 1950 loss as a consolidated net operating loss to 1953. It is contended that there was a sound business purpose for the acquisition of control of Hilo Gas by Refiners and that there was no tax evasion or avoidance purpose.

The position of the defendant is that the carryforward can be denied because the "principal purpose" of the acquisition of control of Hilo Gas was tax evasion or avoidance within the meaning of Section 129 of the Code of 1939, or because there was no "business purpose" for the acquisition or because there was no "economic loss" to the parent corporation.

II.

Can Refiners deduct in the year of its liquidation expenses of selling its capital stock?

The plaintiff's position is that these expenses are deductible in the year of complete liquidation.

The defendant contends that these expenses are not deductible in any year.

III.

Can Refiners deduct in 1955 Territory of Hawaii income taxes allocable to gain from the sale of its properties realized in 1955 but not recognized for Federal income tax purposes by reason of Section 337 of the Internal Revenue Code of 1954?

The plaintiff maintains that the Hawaii income taxes are deductible under Section 164(a) of the Internal Revenue Code of 1954 and that Section 265 of that Code is not applicable.

The defendant insists that Section 265 is applicable, and that for this reason the deduction for Territorial taxes was correctly disallowed.

2. Stipulation of Facts.

The case was submitted to the Court on a stipulation of facts. Sharply abridged, that stipulation is as follows:

Refiners was organized as a corporation under the laws of Hawaii in 1949. It was dissolved on November 19, 1956, and the plaintiff was appointed Trustee for the creditors and the stockholders.

Refiners had an initial authorized capital of $250,000, represented by 250,000 shares of common stock of the par value of $1 each. Honolulu Gas Company, Limited, hereinafter Honolulu Gas, purchased at par the initial 250,000 shares of common stock of Refiners, and in 1949 distributed such stock as a dividend to the stockholders of Honolulu Gas.

After its organization, Refiners engaged in the merchandising of gas appliances, and commenced the construction of its refinery. To pay for that construction work, it borrowed $650,000 on short-term promissory notes. In May, 1950, Refiners sold to the public an additional 500,000 shares of common stock and $750,000 worth of 15-year, 6%, sinking fund

debentures. The net proceeds of this issue were estimated at $1,225,445. In connection with this offering, Refiners incurred expenditures attributable to the issuance of its shares of common stock in the amount of $9,259.74.

In December, 1950, Refiners completed the construction of its refinery.

In April, 1951, Refiners sold an additional 750,000 shares of common stock to the public. The net proceeds from this issue were estimated at $734,400. In connection with this issue, Refiners incurred capital stock expenses of $21,418.88.

Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane—a form of liquefied petroleum gas—in Hawaii. The corporation was not a public utility, and none of its business was subject to regulation by the Public Utilities Commission of Hawaii, hereinafter the Commission.

Refiners entered into an oil and butane contract with Standard Oil of California, hereinafter Standard, in 1949, for a period of ten years for the purchase of petroleum and butane. The Hilo Gas Company, Limited, hereinafter Hilo Gas, after its conversion to butane air in 1951, used more than 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners.

Hilo Gas was organized as a corporation in Hawaii in 1927. It manufactured gas from oil and distributed it through gas mains in Hilo, and was a

public utility subject to regulation by the Commission.

In 1948-1949, Hilo Gas was in financial difficulty. In 1950, A. E. Englebright, who was then the general manager of Refiners, was approached by Orlando Lyman, the president and largest stockholder of Hilo Gas, for assistance in solving the problems of the latter company.

The proposition was made that Hilo Gas cease the manufacture of gas from oil and buy butane from Refiners, which Hilo Gas would then distribute through its gas mains in Hilo as a public utility. This would save manufacturing costs and reduce gas rates to a point where they might be competitive with electric rates.

The feasibility of the Hilo Gas plan depended to some extent on the condition of its gas mains. Englebright sent L. L. Gowans, chief engineer of Honolulu Gas, to Hilo to make a survey. Gowans reported that the gas mains were in adequate condition, and that it would be entirely feasible to distribute butane air mix in the Hilo Gas distribution system without too great a loss in leakage.

On August 7, 1950, Refiners proposed to Lyman that it supply Hilo Gas with butane at 16 cents per gallon. Refiners would also provide equipment and appurtenances for butane air installation at the Hilo plant for about $25,000, to be repaid by Hilo Gas through an additional 1 cent per gallon payment for all butane used in its system. Lyman,

however, in addition wished to acquire the franchise for distribution of "Isle-Gas," Refiners' trade name for butane that it distributed in tanks or containers for use by rural customers, throughout the Island of Hawaii at the price quoted for use in the Hilo Gas mains.

After extended negotiations, on October 5, 1950, the Board of Directors of Refiners authorized the purchase by it of all the stock of Hilo Gas.

The Hilo Gas stock was purchased by Refiners rather than by Honolulu Gas, because Refiners, as the distributor of butane, had the primary interest in securing the Hilo market.

On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas had been acquired by Refiners—all but 164 shares. Refiners never acquired more than 1,872 of the 1,929 outstanding shares of the 7% preferred stock of Hilo Gas and did not acquire the last minority-owned share of the 8% preferred stock until shortly before the dissolution of Hilo Gas in 1956.

The total cost to Refiners of the Hilo Gas stock was $63,897.20.

Under Hawaiian law, no public utility may dispose of property connected with its duties without first securing from the Commission an "order" authorizing it to do so. Without such order, every such disposition of property shall be void. Section 104-18, Revised Laws of Hawaii, 1955.

On October 20, 1950, Hilo Gas filed a petition with the Commission in which it recited that it proposed to sell all its assets, except those related to the appliance sales and liquefied petroleum gas business, to Honolulu Gas for approximately $60,000. The Commission, in an order filed on November 15, 1950, authorized Hilo Gas to sell its utility assets to Honolulu Gas for $64,000.

Hawaiian law requires that the sale of substantially all of the property receive the affirmative vote of three-fourths of all stock issued and outstanding and having voting power. Section 170-30, RLH, 1955. The stockholders of Hilo Gas authorized the sale of the Company's utility assets to Honolulu Gas and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas executed a bill of sale transferring to Refiners for $18,500 the assets relating to the appliance sales and liquefied gas business.

On October 31, 1950, Hilo Gas and Honolulu Gas executed an instrument whereby Hilo Gas conveyed to Honolulu Gas for $46,000 its utility manufacturing plant, etc., and Honolulu Gas assumed the liabilities of Hilo Gas. Possession of these assets was not taken by the purchasers until after October 31, 1950.

On the same day, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and to Refiners for $88,754.32. Such consideration consisted of cash in the amount of $46,000, paid

by Honolulu Gas, $18,500 in cash paid by Refiners, and assumption of liabilities amounting to $25,254.32 by Honolulu Gas. The utility assets were sold to Honolulu Gas at $122,930.58 less than their net book value, and consisted of "property used in the trade or business" as defined in Section 111(j)(1), Internal Revenue Code of 1939.

After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas to Honolulu Gas, the necessary facilities for converting the Hilo system to butane air were ordered. Until April 1, 1951, all of the gas furnished to Hilo was manufactured at the old plant of Hilo Gas.

Hilo Gas had never claimed an obsolescence or abandonment loss for tax purposes on any of the utility assets sold by it to Honolulu Gas on October 31, 1950.

The utility assets sold to Honolulu Gas on October 31, 1950, and abandoned, scrapped or transferred to the Honolulu Division by Honolulu Gas after April 1, 1951, totaled $52,839.65. Utility assets, other than cash, receivables, inventories and supplies, sold to Honolulu Gas on October 31, 1950, that were continued in use in the Hilo operations of Honolulu Gas after April 1, 1951, totaled $113,-635.15.

As a result of the sale of these utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss of $117,792.57 for 1950.

Refiners and Hilo Gas filed consolidated Federal income tax returns for 1950-53, inclusive. Refiners and Hilo Gas filed separate returns for 1954 and 1955. Both companies filed separate Territorial income tax returns for 1950-1955, inclusive.

In 1950 Refiners suffered a loss of $93,092. In 1951 it had a net income of $17,445, and in 1952, $39,147. It did not have to pay any Federal or Territorial income taxes in those years. In 1953 it had a net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954 it has a net income before income taxes of $215,735.66, and after income taxes (as reported) of $104,977. All the foregoing figures are on an unconsolidated basis.

Hilo Gas filed annual "Corporation Exhibits" required by Territorial Law for 1950-1955. Those Exhibits showed the following:

Year	Total Income	Total Expenses	Net Income Before Taxes
1951	$19,294.16	$18,324.96	$ 969.20
1952	10,732.76	10,273.26	459.50
1953	8,600.00	5,830.71	2,769.29
1954	8,600.00	6,009.25	2,590.75
1955	8,700.00	6,063.04	2,636.96

Hilo Gas was dissolved effective September 18, 1956.

Although Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities, actually it did not sell or distribute all its assets in that year. In fact, it continued its corporate ex-

istence and activities until it was dissolved in 1956 by order of the Treasurer of the Territory of Hawaii, supra.

On October 31, 1950, Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities, supra. On the same date it transferred its merchandise and liquefied petroleum gas business to Refiners for $18,500. Hilo Gas retained certain assets in addition to the $64,500 cash received from the sale of its properties.

Refiners included the net loss from the sale in October, 1950, of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas. The Commissioner has disallowed this item, which amounted to $116,405.64, supra. In the explanation for this disallowance, the Commissioner stated:

"* * * it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. Accordingly, the net loss, if any, sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed

as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is, therefore, disallowed."

On June 4, 1957, the plaintiff, as Trustee for the creditors and stockholders of Refiners, paid a deficiency of $58,472.39, together with interest of $11,-301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas in 1950 upon the sale of the utility assets to Honolulu Gas.

On August 28, 1957, the plaintiff duly filed a claim for refund for 1953, covering the payment referred to in the preceding paragraph.

On October 23, 1957, a Notice of Disallowance in full of the plaintiff's claim for refund of $69,774.38 for 1953 was mailed to the plaintiff, and no part of that sum has been refunded to the plaintiff.

On December 6, 1955, the refinery facilities of Refiners were sold to Standard, and the Isle-Gas business and assets were sold to Honolulu Gas on December 31, 1955. Refiners was dissolved by order of the Territorial Treasurer on November 19, 1956. No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas, pursuant to Section 337 of the Internal Revenue Code of 1954.

In its tax return for 1955, Refiners claimed a deduction for organization expenses of $43,163.48.

Included therein was the amount of $30,678.62, relating to expenses in connection with the issue of capital stock, $9,259.74 and $21,418.88 in 1951. The Commissioner's Appellate Division disallowed this claim, stating that "these expenses incurred in marketing your capital stock do not constitute organization expenses, but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital."

In its 1955 income tax return, Refiners claimed a deduction for accrued territorial net income taxes of $67,648.77, based on the net income reportable for territorial net income tax purposes. The income included (1) the gain from the sale of Isle-Gas business and related assets to Honolulu Gas in December, 1955, and (2) the gain from the sale of refinery facilities and related assets to Standard. The Commissioner has disallowed that portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets, under the provisions of Section 265 of the Internal Revenue Code of 1954. The Commissioner stated that that Section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total Territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for Federal income tax purposes, was $61,061.59.

The Commissioner assessed a deficiency of $51,-468.20, plus interest of $3,850.97, against Refiners for 1955, principally because of his disallowance of

the capital stock expense—$30,678.62, supra—and his disallowance of the 1955 Territorial income taxes—$61,061.59, supra. The plaintiff paid the entire amount of that deficiency, in installments.

On August 28, 1957, the plaintiff duly filed a claim for refund with the District Director of Internal Revenue for $51,219.79, plus interest of $3,753.77, or a total of $54,973.56. On October 23, 1957, a Notice of Disallowance in full of the plaintiff's claim for the above amount was mailed to the plaintiff by the District Director. No part of the above claim for refund has been paid to the plaintiff.

3. The Plaintiff's Argument.

Hilo Gas, Refiners' subsidiary, suffered a net operating loss in 1950, which Refiners is entitled to carry forward as a consolidated net operating loss to 1953.

Under the plain terms of the statute and regulations, Refiners is entitled to include the Hilo Gas loss on the sale of its utility assets in its consolidated net operating loss for 1950, and to carry it forward as a consolidated net operating loss to 1953.

A deductible loss was sustained on the sale of utility assets by Hilo Gas to Honolulu Gas in 1950.

The Hilo Gas loss was sustained after affiliation with Refiners, not before. Hilo Gas could not have claimed an abandonment loss or an obsolescence deduction for the pre-affiliation period.

II.

The expenses of selling Refiners' capital stock are deductible in the year of liquidation.

It is established that the organization expenses of a corporation may be deducted in the year of dissolution when all assets are disposed of and nothing remains but winding up.

Capital stock costs here involved are not salesmen's commissions, but are ordinary out-of-pocket expenses—attorneys' and accountants' fees, printing expenses, and charges of the stock subscription agent. There is no rational way of distinguishing these expenses from other organization expenses, and they should be allowed as a deduction when the corporation liquidates.

III.

Territorial income taxes on capital gains realized in 1955 are deductible.

It has been stipulated that no gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas, pursuant to Section 337, Internal Revenue Code of 1954.

Section 164(a) provides that, except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Refiners is entitled to the deduction for Territorial taxes for 1955.

4. The 1950 Book Loss Suffered by Hilo Gas in the Sale of Its Assets to Refiners Is Not Available to the Latter as a "Net Operating Loss Carryover."

This Court believes that the defendant is correct in its contention that the Commissioner's action in disallowing the claimed "loss carryover" was correct.

Refiners should be denied the benefit of the Hilo Gas loss through the filing of consolidated returns, since Refiners has not established that "the principal purpose for" the acquisition of Hilo Gas was not for "evasion or avoidance of Federal income * * * tax."

Section 129 of the Internal Revenue Code of 1939 is explicit on the subject:

"(a) Disallowance of deduction, credit or allowance. If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by se-

curing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed."
(Emphasis supplied.)

Quite aside from Section 129, however, Section 141 of the Code of 1939, which extends the privilege of making consolidated returns to affiliated groups, may not be utilized to distort income by acquiring a "loss corporation" for a nominal consideration, and then using such corporation's losses to avoid taxes.

The total cost of the Hilo Gas stock to Refiners was $63,897.20. Refiners by its purchase acquired "95% or more" of the outstanding capital stock of Hilo Gas. At a hearing before the Commission on October 26, 1950, K. A. Conningham, assistant treasurer of Refiners, testified that his company had purchased approximately 95% of the capital stock of Hilo Gas from various stockholders, and that the acquisition was completed "about ten days ago."

On October 31, 1950, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and to Refiners for $88,754.32.

The defendant argues with much force that there is here presented the question whether the acquisition for $63,897.20 of 95% of the stock of a corporation which shortly afterward was sold for assets of $88,754.32 entitles Refiners to the carryover of a $117,792.57 loss attributable to the sale of those same assets.

The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had been made to purchase the Lyman and Hutchinson stock.

As a matter of fact, however, Hilo Gas lost money in 1948 and 1949, and was in financial difficulty. In such a situation, it has been held that the principal purpose of the acquisition was the avoidance of Federal income taxes.

In Elko Realty Company v. Commissioner, 29 T.C. 1012, affirmed, 3 Cir., 1958, 260 F. 2d 949, 950, the Tax Court had sustained the Commissioner's determination that the principal purpose of the acquisition of the two corporations by the taxpayer was the avoidance of Federal income taxes, that the deduction of their losses from the taxpayer's income was accordingly forbidden by Section 129(a), supra, and that the two corporations were in any event not affiliates of the taxpayer privileged to join in a consolidated return under Section 141, supra, since the taxpayer's acquisition of them served no business purpose, as distinguished from a tax-reducing purpose.

In such a situation, the Court of Appeals said:

"It will be seen that the question upon which this case turns is a purely factual one, namely, whether the taxpayer acquired the two corporations in question for a bona fide business purpose or, as the Tax Court found, principally in order to reduce

or avoid income taxes on its own income. The evidence is discussed and the facts are found in the opinion filed in the Tax Court by Judge Train, 29 T.C. 1012, and will not be detailed here. We need merely say that our examination of the evidence satisfies us that the findings of the Tax Court have substantial evidence to support them and cannot be held to be erroneous."

An examination of the opinion of the Tax Court in that case discloses facts similar to those at bar. Harold J. Fox was Elko Realty's vice president, executive head, and owner of about 80% of its stock. Harry Spiegel was the owner and operator of the two acquired corporations—Spiegel Apartments, Inc., and Earl Apartments, Inc.

On January 1, 1951, Fox acquired 324 shares of the common stock of Spiegel Apartments and 440 shares of the common stock of Earl Apartments. The shares in question represented the only outstanding common stock of both corporations.

The respondent Commissioner having determined that the principal purpose of the acquisition was the avoidance of income tax, the burden was on the petitioning taxpayer to prove otherwise.

The two corporations were operating at a loss at the time of their acquisition, and continued to operate at a loss. The taxpayer corporation filed consolidated returns with the Spiegel and Earl corporations for 1951, 1952, and 1953, and attempted to deduct their losses.

Commenting upon the evidence adduced to show a business purpose, the Tax Court, in 29 TC at page 1025, observed:

"As we have seen, neither Fox nor the petitioner saw any operating books of the two corporations prior to their acquisition. Nor does the record suggest that they made any effort to develop such information. Harry Spiegel was the owner and operator of the 2 corporations and, even if he had had no books and records whatsoever, it would seem reasonable to expect a prospective purchaser of his business to make at least informal inquiry of him concerning its operations. Aside from Spiegel's apparent assurance that both projects were fully occupied, the record fails to disclose that petitioner, either through Fox or otherwise, made any inquiry of Spiegel as to the financial success or lack of it of the two corporations. There is certainly no suggestion that Spiegel or anyone else for that matter actually represented to Fox or the petitioner (Elko Company) that the two corporations, or either of them, were operating at a profit.

Under the circumstances, for petitioner to expect us to give serious credence to its assertion that through Fox, a thoroughly experienced business man, it entered into the transaction in question for a bona fide business purpose requires a degree of naivete which we do not possess."

Finally, it is well settled that "Unquestionably the burden of proof is on the taxpayer to show that

the commissioner's determination is invalid." Helvering vs. Taylor, 1935, 293 U.S. 507, 515, and cases there cited.

In the instant case, as we have seen, the taxpayer has fallen far short of discharging that burden.

5. Expenses Connected With the Issuance of Stock Are Not Deductible in the Year of a Corporation's Dissolution; They Cannot Constitute a Charge Upon Income.

In the tax return for 1955, Refiners claimed a deduction for "organization expenses" of $43,163.48. Included therein was $30,678.62 relating to expenses in connection with the issuance of capital stock in 1951 and 1952. The Commissioner disallowed this latter item as not constituting organization expenses.

It is hornbook law, of course, that the mere fact that an expenditure is made does not entitle the taxpayer to a deduction. Since Congress has the power to prescribe deductions, the right to such a diminution must come within some applicable provision of the statute, else it does not exist. And the provision relied upon, being a matter of legislative "grace," must be "clear." New Colonial Ice Co. vs. Helvering, 1934, 292 U.S. 435, 440.

In Corning Glass Works vs. Lucas, CA D.C., 1929, 37 F. 2d 798, 799, certiorari denied, 1930, 281 U.S. 742, the appellant entered into a contract with certain bankers, under which the latter agreed to purchase at a price of $100 per share, and accrued

dividends, any part of an issue of $3,000,000 preferred stock not taken by stockholders, the bankers to receive for their services, the sum of $240,000. The appellant, on account of these payments to the bankers, sought in its income tax returns to deduct $6,000 from its gross income for 1921 and $236,000 from its gross income for 1922.

The Court quoted extensively from Simmons vs. Commissioner, 1 Cir., 1929, 33 F.2d 75, 76, where it was observed:

"While expenses for organization or for obtaining additional capital are frequent in growing and successful enterprises, we think it clear that they are not 'ordinary and necessary expenses' in the productive operations of such concerns within the meaning of the tax laws."

The District of Columbia appellate court then proceeded to analyze the expenditure in that case, saying:

"In the instant case, appellant sold to Estabrook & Co. (the bankers) preferred stock of the value of $3,000,000 at a discount of $8 per share; so that appellant received, not $3,000,000, but $2,760,000; in other words, $92 per share. The effect of this transaction was to reduce by the amount of $240,000 the capital available to appellant. In other words, it represents a capital expenditure, and should be charged against the proceeds of the stock, and not be recouped out of operating earnings. The regulations and rulings of the Treasury Department have

consistently been to the effect that expenses incident to the sale of the capital stock of a corporation are not 'ordinary and necessary expenses incurred in carrying on the business' of such corporation." (Emphasis supplied.)

In summary, costs of marketing stock are not deductible in the year of organization; or as ordinary and necessary business expenses when incurred; and they are not deuctible in the year of dissolution. In a word, they are not deductible at any time.

The amount of $30,678.62 was properly disallowed by the Commissioner.

6. Refiners Cannot Claim a Deduction on Its 1955 Federal Income Tax Return for Territorial Income Taxes Allocable to Gain From the Sale of Its Properties. Such Gain Is Not Recognizable for Federal Tax Purposes.

In December, 1955, in accordance with a plan of complete liquidation, Refiners sold all its assets to Standard and Honolulu Gas. No gain or loss to Refiners was recognized on that sale for Federal tax purposes, pursuant to Section 337 of the Code of 1954. The total territorial income tax paid by Refiners for 1955 was $74,408.15. The Commissioner disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets, stating that Section 265 of the Code of 1954 "prohibits the deduction of expenses allocable to income exempt from Federal income tax." The amount of the total Territorial net income tax of

$74,408.15 allocable to these gains and disallowed by the Commissioner for Federal income tax purposes, was $61,061.59.

Section 265(1) of the Code of 1954 reads as follows:

"No deduction shall be allowed for——

"(1) Expenses—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle."

Section 1.265-1(b) of the Treasury Regulations reads as follows:

"Section 1.265-1 Expenses relating to tax exempt income.

* * *

"(b) Exempt income and nonexempt income.

"(1) As used in this section, the term 'class of exempt income' means any class of income (whether or not any amount of such class is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Internal Revenue Code of 1954. For the purposes of this section, a class of income

which is considered as wholly exempt from the taxes imposed by subtitle A includes any class of income which is——

"(i) Wholly excluded from gross income under any provision of subtitle A, or

"(ii) Wholly exempt from the taxes imposed by subtitle A under the provisions of any other law.

"(2) As used in this section the term 'non-exempt income' means any income which is required to be included in gross income."

From the foregoing, it is apparent that there are only two classes of income involved; taxable income and exempt income, the latter being defined as that which is not required to be included in gross income.

As we have seen, it is agreed that "No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas," under the provisions of Section 337 of the Code of 1954. Accordingly, it must qualify as exempt income. Since the gain is not included in Refiners' income, it follows that there is no basis for allowing a deduction for the expenses—that is to say, the Territorial tax—related to such income.

This Court cannot go along with counsel's effort to escape this logic.

Without laboring the point further, the Court holds that the Commissioner correctly disallowed

the claimed deduction for Territorial taxes paid, since they relate to an income-source of Refiners that is exempt from tax under Section 265(1) and the applicable Treasury Regulations, supra.

7. Conclusion.

In summary, the Commissioner's disallowance of the loss on the sale of the Hilo Gas assets and his disallowance of the claimed deductions for organization expenses and Territorial tax, were correct.

Accordingly, this Court concludes that the plaintiff should take nothing by its Complaint, and that the defendant should have its costs. It is, therefore,

Ordered, that the defendant have judgment against the plaintiff, together with its costs in this action incurred.

Counsel for defendant is directed to prepare and lodge with the Court findings of fact and conclusions of law, and form of judgment which when adopted and filed will constitute the findings, conclusions and judgment of this Court.

Dated at Las Vegas, Nevada, this 18th day of November, 1959.

/s/ JOHN R. ROSS,
United States District Judge.

[Endorsed]: Filed November 24, 1959.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is an action brought by plaintiff as Trustee for the creditors and stockholders of Pacific Refiners, Limited, a dissolved Hawaiian corporation to recover $109,692.18, representing deficiency income taxes for the calendar years 1953 and 1955 and $15,055.76 interest on said deficiency, which was assessed against and collected from plaintiff, together with interest thereon as provided by law.

This action having come on regularly for trial before the Honorable John R. Ross, United States District Court Judge, sitting without a Jury, plaintiff appearing by Marshall M. Goodsill, its attorney of record and the defendant appearing by Louis B. Blissard, United States Attorney for the District of Hawaii, its attorney of record; and all of the facts and exhibits in this action having been fully stipulated, and the court after considering all of the evidence set forth in the stipulation of facts and the contentions of each respective party, and having given due weight to the arguments set forth in the briefs of the respective parties, hereby makes and enters its

Findings of Fact

1. The findings of fact are as set forth in the "Stipulation of Facts," pages 3 through 11 in the

Opinion and Judgment filed herein on November 24, 1959.

Conclusions of Law

1. This Court has jurisdiction of the subject matter and of the parties hereto.

2. Plaintiff has not sustained its burden of proof that the Commissioner erred in refusing to permit Refiners to carry over the adjusted loss sustained by Hilo in 1950 as a net operating loss carryover in the consolidated income tax return filed by Refiners for the year 1953.

3. Refiners is not entitled to the benefit of the loss sustained by Hilo in 1950 as a carryover net operating loss in determining its consolidated net taxable income for the year 1953, since Refiners has not established that the principal purpose for the acquisition of Hilo was not for the evasion or avoidance of federal income tax, as required by Section 129 of the Internal Revenue Code of 1939.

4. The cost of marketing Refiners' capital stock is not deductible as an ordinary and necessary expense either in the year of organization or during the year the expenditures were incurred or in the year of dissolution of Refiners, and therefore the Commissioner correctly and properly disallowed the sum of $30,678.62, representing the cost of marketing Refiners' capital stock included in the organization expense claimed as a deduction for the year 1955, in determining its net taxable income for that year.

5. Under the provisions of Section 265(1) of the Internal Revenue Code of 1954, no deduction is allowable for any amount otherwise allowable as a deduction, which is allocable to one or more classes of income wholly exempt from taxes imposed by Sub-title A of the 1954 Code. Since no gain or loss to Refiners was recognized on the sale of its assets in 1955 to Standard Oil Company and Honolulu Gas under the provisions of Section 337 of the Internal Revenue Code of 1954, this nontaxable gain qualifies as exempt income under Section 265(1) of the 1954 Code, and therefore Refiners is not entitled to the claimed deduction of $61,061.59 for the year 1955 in determining its net taxable income for that year.

6. Plaintiff is entitled to take nothing by this action and judgment should therefore be entered for the defendant on the merits, dismissing the action with prejudice, the defendant to recover its costs, if any, from plaintiff.

/s/ JOHN R. ROSS,
United States District Judge.

Dated: February 26, 1960.

Approved as to Form:

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

[Endorsed]: Filed March 4, 1960.

In the United States District Court
For the District of Hawaii

Civil No. 1619

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant,

JUDGMENT ORDER

The above-entitled cause having come on regularly for trial before this Court, the Honorable John R. Ross, United States District Court Judge, presiding therein, sitting without a jury, plaintiff and the defendant appearing by their respective attorneys, and all of the facts having been stipulated by written stipulation filed herein between the parties, and briefs having been filed by and in behalf of the respective parties, and the Court, having duly considered the same and having rendered its Opinion and made and entered its Findings of Fact and Conclusions of Law;

It is therefore, Ordered, Adjudged and Decreed that plaintiff is not entitled to any recovery prayed for in the Complaint and that judgment is hereby

entered dismissing the complaint with costs, if any, to be assessed against plaintiff.

/s/ JOHN R. ROSS,
District Judge.

Entered February 26, 1960.

Approved as to Form:

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

[Endorsed]: Filed and entered March 4, 1960.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Hawaiian Trust Company, Limited, a Hawaii corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action.

Bond for Costs on Appeal in this action was filed with this court on January 21, 1960.

Dated: Honolulu, Hawaii, March 11, 1960.

/s/ MARSHALL M. GOODSILL,
Attorney for Appellant, Hawaiian Trust Company, Ltd.

Receipt of copy acknowledged.

[Endorsed]: Filed March 11, 1960.

[Title of District Court and Cause.]

STATEMENT OF POINTS ON APPEAL

Pursuant to Rule 75(d) of the Federal Rules of Civil Procedure, Hawaiian Trust Company, Limited, plaintiff-appellant in this action, states that the following are the points upon which plaintiff-appellant will rely on appeal:

1. The United States District Court for the District of Hawaii erred in concluding that plaintiff is not entitled to any recovery prayed for in its complaint and in dismissing the complaint in this action.

2. Hilo Gas Company, Limited, suffered a net operating loss in 1950 which Pacific Refiners, Limited, was entitled to carry forward as a consolidated net operating loss to 1953.

3. Pacific Refiners, Limited, was entitled to deduct in 1955 Hawaii income taxes allocable to capital gains realized in 1955 but not recognized for federal income tax purposes by reason of Section 337, Internal Revenue Code 1954.

Dated: Honolulu, Hawaii, March 11, 1960.

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff-Appellant, Hawaiian Trust Company, Limited.

Service of copy acknowledged.

[Endorsed]: Filed March 11, 1960.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Hawaii—ss.

I, William F. Thompson, Jr., Clerk of the United States District Court for the District of Hawaii, do hereby certify that the foregoing record on appeal in the above-entitled cause, numbered from Page 1 to Page 126 consists of a statement of the names and addresses of the attorneys of record and of the various original pleadings as hereinbelow listed and indicated:

Complaint and Summons.
Answer.
Stipulation of Facts.
Stipulation With Respect to Questions of Law.
Opinion and Judgment.
Findings of Fact and Conclusions of Law.
Judgment Order.
Notice of Appeal.
Statement of Points on Appeal.
Bond for Costs on Appeal.
Designation of Contents of Record on Appeal.
Counter-Designation of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 24th day of March, 1960.

[Seal] /s/ WM. F. THOMPSON, JR.,
Clerk.

[Endorsed]: No. 16859. United States Court of Appeals for the Ninth Circuit. Hawaiian Trust Company, Limited, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Hawaii.

Filed March 31, 1960.

Docketed: April 12, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.